FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, MAY 14, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Coons, Johanns, and Moran.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. MARY JO WHITE, CHAIR

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. The subcommittee will come to order.

I am pleased to convene this hearing of the Financial Services and General Government Subcommittee to consider the fiscal year 2015 funding requests of two key Federal regulatory agencies, the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

I welcome my distinguished ranking member, Senator Mike Johanns, and some of our other colleagues I think will join us here throughout the day.

Joining us today are also the Honorable Mary Jo White, Chair of the Securities and Exchange Commission, and the Honorable Mark Wetjen, Acting Chairman of the Commodity Futures Trading Commission. They will discuss the critical work of their agencies, their use of resources provided over the past couple of years, and their budget needs for fiscal year 2015.

The workload for these agencies has grown dramatically in recent years. The SEC and the CFTC all play critical roles in stimulating and sustaining economic growth and prosperity in our country, in protecting the marketplace from fraud and manipulation, and in carrying out Dodd-Frank reforms. My constituents have made clear they support these reforms to prevent the reckless and abusive practices that led to the financial crisis.

Fortunately, some sectors of our country are recovering. But sadly, many families have not recovered, and they continue to struggle. I believe it is my responsibility to the hard-working and honest people of New Mexico and to all Americans who suffered as

a result of this crisis to ensure that we work to fully implement Dodd-Frank.

We need a financial system that is safe and sound because what happens on Wall Street touches every American family. Whether they are saving to buy their first home, helping to put their children through college, or planning for retirement, they put their faith in the financial markets being sound. We cannot let them down.

And they are not alone. Market users, financial investors, and the U.S. economy all depend on vigilant oversight by these two agencies, especially in today's rapid-paced, evolving, and often volatile global marketplace.

In the past few years, both Chair White and Acting Chairman Wetjen and their fellow commissioners and their respective staffs I think have worked very hard to create a more reliable regulatory structure to ensure the stability and integrity of the futures and securities markets. But there is still, I think everyone will admit, a lot of work to be done.

We depend on your leadership to implement the reforms designed to strengthen our regulatory framework, to do so promptly, prudently, and transparently, and help guard against another financial meltdown.

As the investors' advocate, the SEC has an important role in maintaining fair, orderly, and efficient stock in securities markets. The SEC conducts day-to-day oversight of the major market participants, monitors corporate disclosure of information to the investing public, and investigates and pursues enforcement action against securities laws violations.

Dodd-Frank dramatically expanded the SEC's responsibilities. The SEC was thrust into the driver's seat for issuing nearly 100 new rules, creating five new offices, issuing more than 20 studies and reports, overseeing the over-the-counter derivatives market and hedge fund advisers, registering municipal advisers and security-based swap market participants, and setting up a new whistleblower program.

The Jumpstart Our Business Startups Act of 2012 (JOBS Act) added more to SEC's plate for further rules and studies on capital formation, disclosure, and registration requirements.

Turning to the CFTC now, the CFTC carries out market surveillance, compliance, and enforcement programs in the futures and swaps arena. It detects, deters, and punishes abusive trading activity and manipulation of commodity prices, helping to prevent negative impacts both on consumers and on the economy.

Four years ago, the CFTC's mission was substantially expanded to include new oversight of the swaps marketplace, the vast once-in-the-shadows world of over-the-counter derivatives. It is a significantly transformed and highly diversified marketplace, one that is globalized, electronic, and around the clock.

The enactment of Wall Street reform in 2010 also added to the job of the CFTC. CFTC now has oversight of the once unregulated $400 trillion over-the-counter U.S. derivatives market to protect and benefit end-users and the broader American public. This complex swaps market has a notional value of nearly eight times the size of that of the futures market.

Now, the forecast for 2015, looking ahead for fiscal year 2015 for the SEC, the President seeks funding of $1.7 billion, an increase of $350 million, 26 percent above the fiscal year 2014 base enacted level of $1.35 billion. It is $236 million above the SEC's $1.464 billion current operating level. The $1.7 billion requested for fiscal year 2015 will support 5,143 permanent positions, an increase of 639 positions over the current 4,504 permanent positions, for a 14 percent growth in staff.

And for the CFTC, the President's budget requests $280 million, an increase of $65 million above the fiscal year 2014 enacted level of $215 million. This is a 30 percent increase in funding above the current level. The proposed fiscal year 2015 level will support 920 staff or 253 more when compared to the current staffing level of 667, a 37 percent increase.

Congress probably exercises its most effective oversight of agencies and programs through the appropriations process, permitting an annual checkup and review of operations, of activities, and spending. Today's hearing provides a valuable opportunity to ask some important questions.

Are the SEC and the CFTC keeping pace with the developments in the markets, particularly with more complex financial products which are emerging?

Do these agencies have the right mix of talent and specialized expertise to be vigilant watchdogs?

Do they have the state-of-the-art information technology to augment and support their human capital?

What are the top priorities for use of the resources proposed for 2015?

And what are the likely consequences of continued budget shortfalls and reduced resources?

I know Senator Johanns and I welcome the opportunity to conduct critical oversight of these two agencies. And I now turn to my distinguished ranking member, Senator Mike Johanns, for his opening remarks.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Mr. Chairman, let me just start out and say thank you to the witnesses for being here with us today. I thank you, Mr. Chairman, for holding yet another important hearing as we work our way through the various budget requests under our subcommittee's jurisdiction.

I do look forward to hearing from the witnesses today regarding the details of your requests as well as your plans to carry out core missions and implement Dodd-Frank in a responsible manner. There are three areas that I would like to highlight, looking forward to your testimony and my questions.

First, the SEC's implementation of the JOBS Act. Where is that on schedule? I am concerned that it is not on schedule, and I want to learn more about that. I do encourage the SEC and your team to move with all appropriate speed in finalizing Regulation A and the crowdfunding rules.

Second, I would like to get both of your thoughts on technological advancement in the marketplace, and what your agencies are doing on the technology front to adapt.

And finally, I ask you to be persistent in trying to work together and coordinate with your fellow regulators. Any conflicts between SEC and CFTC on cross-border swaps and lack of coordination between the SEC and Department of Labor over fiduciary standards continues to cause uncertainty and confusion.

Derivatives markets and effective oversight of those markets matter a lot to farmers, to homeowners, and to small businesses. We all benefit from a system that promotes fair and orderly markets. So I am concerned when certain agency rules seem to fragment the market and push businesses overseas.

In some instances, the CFTC has moved too quickly. Others, the Commission has simply chosen to issue guidance in what looks like an effort to avoid cost-benefit analysis. In many cases, the Commission has opted to act alone instead of properly coordinating with the SEC as well as other domestic and international regulators.

In order to be an effective regulator, transparency is critical. This need for transparency and coordination is evident in the CFTC's approach to cross-border implementation swaps regulation. CFTC's guidance, the delays, the lack of coordination with other regulators have led to confusion and concern for market participants, foreign government finance ministers, and investors here and abroad.

No doubt that both the CFTC and SEC have an important job of protecting investors who look to the markets to help secure their retirements, pay for their homes, send kids to college. Your agencies have an obligation to protect consumers, hopefully, from the next Madoff, MF Global, or Stanford.

As we look at both of your budget requests, two things come to mind. First, technological solutions are important to keep up with next-generation trading platforms that operate at lightning speeds. Two, staffing levels have to be carefully considered. We also have to make sure that they are sustainable.

All agencies have to make strategic decisions on how best to allocate resources. As we all know, simple increasing funding doesn't necessarily ensure that the agency will successfully achieve its mission.

So, to the chairs, you both have difficult tasks before you. We ask a lot. We ask that you improve transparency in our securities markets, uncover fraud and deception, without over-regulating our markets and hindering economic growth.

Chairman Udall, again, I look forward to working with you as we consider the fiscal year 2015 budget requests of the CFTC and the SEC, and I look forward to the testimony and the opportunity to ask questions.

Thank you, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns.

And at this time, I would invite Chair White to present testimony on behalf of the SEC, followed by Acting Chairman Wetjen on behalf of the CFTC. You each will have 5 minutes. I know you have very thorough statements, which will be put in the record, and you can use your 5 minutes as you choose.

Please proceed, Chair White.

SUMMARY STATEMENT OF HON. MARY JO WHITE

Ms. WHITE. Thank you, Chairman Udall, Ranking Member Johanns. Thank you for inviting me to testify in support of the President's fiscal year 2015 budget for the Securities and Exchange Commission.

Now more than ever, investors and our markets need a strong, vigilant, and adequately resourced SEC. To put the SEC's extensive responsibilities and its 2015 budget request into context—from fiscal year 2001 to fiscal year 2014, trading volume in the equity markets more than doubled to a projected $71 trillion. The complexities of financial products and the speed with which they are traded increased exponentially.

Assets under management of mutual funds grew by 131 percent to $14.8 trillion, and assets under management of investment advisers jumped almost 200 percent to $55 trillion. There are today over 25,000 SEC registrants, including broker-dealers, clearing agents, transfer agents, credit rating agencies, exchanges, and others.

During this time of unprecedented growth and change in our markets, the SEC also has been given significant new responsibilities for over-the-counter derivatives, private fund advisers, municipal advisors, crowdfunding portals, and more.

The President's $1.7 billion budget request would enable the SEC to address critical core priorities including enhancing examination coverage for investment advisers and other key entities who deal with retail and institutional investors; protecting investors by expanding our enforcement program's investigative capabilities, and strengthening our ability to litigate against wrongdoers; deploying and leveraging cutting-edge technology to better keep pace with those we regulate, make our operations more efficient, and improve our ability to identify a variety of market risks, including emerging frauds.

The SEC's funding, as you know, is deficit neutral, which means that the amount Congress appropriates is offset by transaction fees and thus does not impact the deficit, the funding available for other agencies, or count against the caps in the congressional budget framework.

Nonetheless, I fully recognize my duty to be an effective and prudent steward of the funds we are appropriated. I believe our accomplishments in the past year should give Congress and the public confidence that we will fulfill this responsibility.

RECENT SEC ACCOMPLISHMENTS

While certainly much more remains to be done, since my arrival in April 2013, the Commission has adopted or proposed more than 20 significant rulemakings, including many mandated by the Dodd-Frank and JOBS Acts, across the regulatory spectrum of our jurisdiction. My written testimony details these.

We are also now more aggressively enforcing the securities laws, requiring for the first time admissions to hold certain wrongdoers more publicly accountable. And in fiscal year 2013, we obtained orders for penalties and disgorgements of $3.4 billion, the highest in the agency's history.

We have intensified our data-driven disciplined approach to analyzing and appropriately addressing complex market structure issues, such as high-frequency trading and dark pools, implementing a powerful new analytical tool called MIDAS. We have begun a comprehensive review of the SEC's public company disclosure rules to make disclosures more meaningful to investors while at the same time making them more cost effective for companies.

And I want to make clear that this significant progress I am talking about was due to the incredible commitment, talent, and expertise of the SEC staff. The fiscal year 2015 budget request would permit the SEC to increase its examination coverage of investment advisers who everyday investors are increasingly turning to for investment assistance for retirement and family needs.

SEC FUNDING NEEDS

While the SEC has made the most of its limited resources, we nevertheless were only able to examine 9 percent of registered investment advisers in fiscal year 2013. In 2004, 10 years ago, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, in 2014, we have only eight. More coverage is plainly needed, and the industry itself has acknowledged that.

Very importantly, this budget request would also allow us to better leverage technology across the agency to support a number of key initiatives.

This budget request also allows us to continue augmenting our Division of Economic and Risk Analysis by adding financial economists and other experts to assist with economic analysis in rulemaking, risk-based selection for investigations and examinations, and structured data initiatives.

PREPARED STATEMENT

I firmly believe that the funding we seek is fully justified by our important and growing responsibilities to investors, companies, and the markets. Your continued support will allow us to better fulfill our mission and to build on the significant progress the agency has achieved, which I am committed to continuing and enhancing.

I would be pleased to answer any of your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. MARY JO WHITE

Chairman Udall, Ranking Member Johanns, and members of the subcommittee:

Thank you for inviting me to testify today in support of the President's fiscal year 2015 budget request for the Securities and Exchange Commission.[1] I appreciate the opportunity to describe why and how the SEC needs the $1.7 billion requested for the coming fiscal year in order to fulfill the obligations given to the agency by Congress to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[2]

I am pleased by the SEC's accomplishments this past year. We adopted or proposed a substantial volume of mandated and other key rules. We aggressively en-

[1] A copy of the SEC's fiscal year 2015 Budget Congressional Justification can be found on our website at http://www.sec.gov/about/reports/secfy15congbudgjust.shtml.

[2] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission, or any Commissioner. In accordance with past practice, the budget justification of the agency was submitted by the Chair and was not voted on by the full Commission.

forced the securities laws, changing a key policy that can hold wrongdoers more publicly accountable and obtaining orders for penalties and disgorgement of $3.4 billion in fiscal year 2013, the highest in the agency's history. We launched MIDAS and intensified our review of market structure issues, including high-frequency and off-exchange trading practices. And we have continued to improve our efficiency by enhancing our technology, bringing in more experts, and deploying more risk-based analytics to allow us to do more with our limited resources, and to do so more quickly.

And with last week being Public Service Recognition Week, I want to take this occasion to make clear that none of this would have been possible without the incredible commitment, talent, and expertise of the staff of the SEC.

As described in more detail below, the requested budget level would allow the SEC to build upon its strong efforts and accomplish several key and pressing priorities, including:

—Bolstering examination coverage for investment advisers and other key areas within the agency's jurisdiction;
—Strengthening our enforcement program's efforts to detect, investigate, and prosecute wrongdoing;
—Continuing the agency's investments in the technologies needed to keep pace with today's high-tech, high-speed markets; and
—Enhancing the agency's oversight of the rapidly changing markets and ability to carry out its increased regulatory responsibilities.

SIGNIFICANT GAINS, BUT WORK REMAINS

The SEC's funding mechanism is deficit-neutral, which means that the amount Congress appropriates to the agency will not have an impact on the nation's budget deficit, nor will it impact the amount of funding available for other agencies.[3] Our appropriation also does not count against the caps set in the bi-partisan Congressional budget framework for 2014 and 2015.

Nonetheless, I deeply appreciate that I have a serious responsibility to be an effective and prudent steward of the funds we are appropriated. Since my arrival just over a year ago, we have made every effort to effectively deploy our funds to accomplish our mission and the goals that Congress has set for us. And, within the last year, we have advanced a significant number of rules and other initiatives across the wide range of our responsibilities with respect to the regulatory objectives mandated for the SEC by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and the Jumpstart Our Business Startups Act ("JOBS Act"), proposing or adopting rules concerning, among other things:

—The registration and regulation of nearly a thousand municipal advisors;
—The cross-border application of our security-based swap rules in the global swaps market;
—Lifting the ban on general solicitation in certain private offerings and proposing rules to provide important data and investor protections for this new market;
—Proprietary trading and investments in private funds by banks and their affiliates, under what is commonly called the "Volcker Rule";
—Increasing access to capital for smaller companies by permitting securities-based crowdfunding;
—Programs required of broker-dealers, investment companies, and other regulated entities to address risks of identity theft;
—Further safeguarding the custody of customer funds and securities by broker-dealers;
—Updating and expanding the Regulation A exemption for raising capital;
—The retention of a certain amount of credit risk by securitizers of asset-backed securities;
—The removal of references to nationally recognized statistical rating organization ratings in our broker-dealer and investment company regulations; and
—Enhancing risk management and other standards for the clearing agencies responsible for the safe and efficient transfer of trillions of dollars of securities each year.

In addition, we put forward rule proposals to strengthen and reform the structure of money market funds and require that certain key market infrastructure participants have comprehensive policies and procedures to better insulate market infrastructure technological systems from vulnerabilities.

[3] Section 991 of the Dodd-Frank Act requires the SEC to collect transaction fees from self-regulatory organizations in an amount designed to directly offset our appropriation. The current fee rate is about $0.02 per every $1,000 transacted.

We also have taken steps to enhance the SEC's already strong enforcement program, including by modifying the longstanding "no admit/no deny" settlement protocol to require admissions in certain cases. While no admit/no deny settlements still make a great deal of sense in many situations, because admissions achieve a greater measure of public accountability, they can bolster the public's confidence in the strength and credibility of law enforcement and in the integrity of our markets. Already the Commission has resolved a number of cases with admissions, and my expectation is that there will be more such cases in 2014 as the new protocol continues to evolve and be applied. The Commission also has brought a number of significant enforcement cases across our regulatory spectrum, including actions against exchanges to ensure they operate fairly and in compliance with applicable rules, actions against auditors and others who serve as gatekeepers in our financial system, landmark insider trading cases, and additional cases against individuals and entities whose actions contributed to the financial crisis.

In the past year, the Commission also has made great strides to improve its technology, including through the development of tools that permit us to better understand and protect the integrity of our markets and inform our exam program. In October 2013, the agency brought on-line a transformative tool called MIDAS that enables us to analyze enormous amounts of trading data across markets almost instantaneously. The SEC's Quantitative Analytics Unit in our National Exam Program has developed groundbreaking new technology that allows our examiners to access and systematically analyze massive amounts of trading data from firms in a fraction of the time it has taken in years past. We are laying the technological foundation for unified access to SEC information, applications, and data across the agency, and are making a variety of other technological investments to enable us to meet our mission more efficiently and effectively.

Despite this significant progress, there is much that the SEC still needs to accomplish. Completing the rulemakings and studies mandated by Congress in the Dodd-Frank and JOBS Acts remains among my top priorities. We must continue to seek to address structural concerns about our complex, dispersed marketplace in a responsible and empirically-based manner, and also continue our current review of the SEC's public issuer disclosure rules. We also need to continue to increase our capacity to examine and oversee the entities under the SEC's jurisdiction, as well as hold accountable those that harm investors through securities law violations. We are at a critical point in the deployment of more sophisticated technology tools and platforms, and it is vital that we have the resources necessary to continue modernizing our IT systems and infrastructure.

The SEC needs significant additional resources to keep pace with the growing size and complexity of the securities markets and the agency's broad responsibilities. The agency currently oversees more than 25,000 market participants, including over 11,000 investment advisers, approximately 10,000 mutual funds and exchange-traded funds, 4,450 broker-dealers, 450 transfer agents, 18 securities exchanges, as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), Securities Investor Protection Corporation (SIPC), and Financial Accounting Standards Board (FASB). The SEC also has responsibility for reviewing the disclosures and financial statements of approximately 9,000 reporting companies, and has new and expanded responsibilities over the derivatives markets, an additional 2,500 reporting advisers to hedge fund and other private funds, close to 1,000 municipal advisors, ten registered credit rating agencies, and seven registered clearing agencies. And, as you know, between the Dodd-Frank and the JOBS Acts, the SEC was given nearly 100 new rulemaking responsibilities.

The SEC's responsibilities are extensive and complex and its mission is critically important. The funding we are seeking is fully justified by our growing responsibilities to investors, companies, and the markets. With what I believe is a thoughtful and targeted approach to our resource challenges, the fiscal year 2015 budget request of $1.7 billion would allow the SEC to hire an additional 639 staff in critical, core areas and enhance our information technology.

Outlined below is a brief overview of some of the key components of our request.

EXPANDING OVERSIGHT OF INVESTMENT ADVISERS AND STRENGTHENING COMPLIANCE

There is an immediate and pressing need for significant additional resources to permit the SEC to increase its examination coverage of registered investment advisers so as to better protect investors and our markets. During fiscal year 2013, due to significant resource constraints, the SEC examined only about 9 percent of these advisers, comprising approximately 25 percent of the assets under management.

The number of SEC-registered advisers has increased by more than 40 percent over the last decade, while the assets under management by these advisers have increased more than two-fold, to almost $55 trillion. At the same time, the industry has been increasing its use of new and complex products, including derivatives and certain structured products, employing technologies that facilitate high-frequency and algorithmic trading, and developing complex "families" of financial services companies with integrated operations that include both broker-dealer and investment adviser affiliates. While the SEC has efficiently used its limited resources by improving its risk assessment IT capabilities and focusing its examination staff and resources on those areas posing the greatest risk to investors, in 2004, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, we have only 8. More coverage is clearly needed as the status quo does not begin to provide sufficient protection for investors who increasingly turn to investment advisers for assistance navigating the securities markets and investing for retirement and family needs.

A top SEC priority under the fiscal year 2015 request is to add 316 additional staff to the examination program in its Office of Compliance Inspections and Examinations (OCIE). This would allow the agency to examine more registered firms, particularly in the investment management industry; build out the examination program to implement newly expanded responsibilities with respect to municipal advisors, swap market participants, private fund advisers, crowdfunding portals and other new registrants; and more effectively risk-target and monitor other market participants. Additionally, OCIE would also be able to continue ongoing efforts to enhance its risk assessment and surveillance through the development of new technologies in areas such as text analytics, visualization, search and predictive analytics.

BOLSTERING ENFORCEMENT

Strong and effective enforcement of our Federal securities laws is central to the SEC's mission. In addition to modifying our settlement policy to require public admissions in certain cases, the Commission in the last year brought groundbreaking cases across the full range of the securities laws, including, among many others, a $615 million settlement of an insider trading case; a failure to supervise case against a prominent hedge fund adviser; actions against exchanges and municipal issuers; Foreign Corrupt Practices Act cases against large multinational corporations; and additional matters against individuals and entities whose actions contributed to the financial crisis.

Notwithstanding these results, the SEC's Division of Enforcement faces a number of key challenges to preserve and enhance its ability to vigorously pursue the entire spectrum of wrongdoing within our jurisdiction. Our Enforcement work includes the detection, investigation, and litigation of violations of the Federal securities laws. In each of these areas, we face significant challenges:

—*Detection.* We receive over 15,000 tips, complaints, and referrals annually, including the more than 3,000 tips that flow into the Division's Whistleblower Office, which generate a fresh stream of case leads in need of investigation. The review and analysis of these tips require significant human and technological resources. We also have focused intensively on potential misconduct in the equity markets and in connection with new rules, including those implemented under the Dodd-Frank and JOBS Acts. But detecting misconduct in constantly evolving securities markets, including as a result of the growth of algorithmic, automated trading and "dark pools," requires substantial resources.

—*Investigations.* Technological advances across the industry allow for more sophisticated schemes, which require improved technology and significant resources to unravel. We also are expanding our focus on financial reporting and auditing misconduct cases, which are highly technical and labor intensive.

—*Litigation.* We have seen an increase in litigation and trials as we focus more extensively on individual wrongdoing. And, the recent change to our long-standing settlement policy that now requires admissions in certain cases may lead to more litigation. Success at trial is critical to our ability to carry out our mission, and litigation, often against well-funded opposition.

In order to meet the challenges of our rapidly changing and expanding markets, with increasingly complex products and more sophisticated wrongdoers, Enforcement seeks to hire 126 new staff, including additional legal, accounting, and industry specialized experts, primarily for investigations and litigation. These critical resources will enable us to improve our information processing and analysis, expand our investigative capabilities, strengthen our litigation capacity, and better use technology. In addition, the Division will continue to: (1) invest in technology that en-

ables the staff to work more efficiently and effectively, and (2) collaborate with external stakeholders who assist in the Division's identification, investigation, and litigation of securities law violations, including wrongdoing that crosses borders.

LEVERAGING TECHNOLOGY

The SEC is strongly committed to leveraging technology to streamline operations and increase the effectiveness of its programs. We are developing new analytic tools designed to process data more efficiently and make timelier and better-informed decisions. For example, we apply cutting-edge analytics, such as visual data analysis, to increase the speed with which the exam and enforcement program evaluate data and develop evidence. To support these tools, we are investing in our information technology infrastructure to store and process increased volumes of data. We generated over $18 million in cost avoidance in fiscal year 2013 through a more efficient data center structure, renegotiated contracts, server virtualization, and other process improvements. Our recently initiated Quantitative Research and Analytic Data Support program is structuring vast quantities of financial market data and making it more accessible across the agency. This program will enhance the quality and speed of data-driven analyses and, importantly, link disparate sources of data to allow staff to establish connections not previously possible.

While the agency has made significant progress over the past few years in modernizing its technological systems, progress was set back by our level of funding in fiscal year 2014. Increased funding for these efforts and new technology investments are essential. The SEC's fiscal year 2015 budget request, which includes full use of the SEC Reserve Fund, would support a number of key information technology initiatives, including:

—*EDGAR modernization,* a multi-year effort to simplify the financial reporting process to promote automation and reduce filer burden. EDGAR provides the most critical window into the capital markets for investors and businesses. With a more modern EDGAR, both the investing public and SEC staff will benefit from having access to better data.

—*Enterprise Data Warehouse,* a centralized repository for the Commission to organize different sources of data, which can help the public gain easier access to more usable market data, which will facilitate easier and more effective analysis.

—*Data analytics tools,* to assist in the integration and analysis of large amounts of data, allowing for computations, algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behavior. We have begun deploying these tools on a limited basis within our enforcement and exam programs, but due to current budget constraints have not yet rolled them out more broadly. Under this request, more front-line staff, including those performing examinations and investigations, would be able to leverage these tools to efficiently identify links, anomalies, or indicators of possible securities violations.

—*Examination improvements,* to improve risk assessment and surveillance tools and datasets that will help the staff monitor for trends and emerging fraud risks, as well as improving the workflow system supporting SEC examinations.

—*Enforcement investigation and litigation tracking,* to support Enforcement teams with the receipt and loading of the high volume of materials produced during investigations and litigation, to build the capability to permit the electronic transmittal of data, and to implement a document management system for Enforcement's internal case files.

—*SEC.gov modernization,* to make one of the most widely used Federal government websites more flexible, informative, easier to navigate and secure for investors, registrants, public companies, and the general public. SEC.gov receives more than 35 million hits per day, and there is high public demand for quick and ready access to the tremendous amount of data available there, including 21 million filings in the EDGAR system and 170,000 documents on SEC.gov. When fully implemented, the website will offer dramatically improved search and filtering capabilities that will enhance the transparency and availability of this data.

—*Tips, Complaints, and Referral (TCR) system enhancements,* to bolster flexibility, configurability, and adaptability. The TCR system is the SEC's central repository of tips, complaints, and referrals that maximizes our ability to search, track, and route workflow for the high volume that the agency receives each year (e.g., over 15,000 in fiscal year 2013). System enhancements will provide automated triage of the items the agency receives, as well as improved intake, resolution tracking, searching, and reporting functionalities.

—*Information security,* to upgrade security tools and processes, and to develop and train staff to monitor, respond to, and remediate ever-increasing risks and security threats and to permit continuous risk monitoring.
—*Business process automation and improvement,* to improve the efficiency and effectiveness of the agency's processes, thereby enabling us to better serve the public.

STRENGTHENING OVERSIGHT OF THE SECURITIES MARKETS AND INFRASTRUCTURE

To effectively assess constantly evolving market activity across a wide range of complex trading venues, the SEC's Division of Trading and Markets must:
—Enhance its effort to address market structure and technology developments, including through MIDAS and other tools that facilitate the analysis of trade and order data that reflects, for example, high-frequency trading and trading on off-exchange venues where pre-trade prices are not typically available to the public;
—Continue its work with self-regulatory organizations (SROs) to enhance critical market infrastructures that are essential for the operation of the securities markets; and
—Expand its oversight of clearing agencies, large broker-dealers, exchanges, and other major securities market participants.

Further, in fiscal year 2015 we expect a significant number of new registrants under the Dodd-Frank and JOBS Acts as registration requirements under those laws go into effect, including dealers and other participants in the security-based swap market and crowdfunding portals. Additional resources are needed to undertake these new market-related responsibilities, including staff focused on market supervision, analytics and research, and derivatives policy and trading practices. Accordingly, for these core and new responsibilities, in the fiscal year 2015 budget request the SEC proposes to add 25 positions in its Division of Trading and Markets.

ENHANCING CORPORATE DISCLOSURE REVIEWS AND SUPPORTING IMPLEMENTATION OF THE JOBS ACT

For fiscal year 2015, the SEC requests 25 new positions for its Division of Corporation Finance. These resources are needed for Corporation Finance to continue its multi-year effort to enhance its disclosure review program for large or financially significant companies, meet the increased workload resulting from expected improved market conditions and additional emerging growth companies confidentially submitting registration statements for non-public review, provide increased interpretive guidance, and evaluate trends in the increasingly complex offerings of asset-backed securities and other structured financial products. During fiscal year 2015, Corporation Finance also will continue to implement the rulemakings required by the Dodd-Frank and JOBS Acts and move forward on a comprehensive initiative to update the disclosure requirements for reporting companies.

FOCUSING ON ECONOMIC AND RISK ANALYSIS TO SUPPORT RULEMAKING AND STRUCTURED DATA AND RISK-BASED INITIATIVES

The SEC's Division of Economic and Risk Analysis (DERA) works to integrate analysis of economic, financial, and legal disciplines with data analytics and quantitative methodologies in support of the SEC's mission. DERA is our most rapidly growing division, having more than doubled since its creation in late 2009. In fiscal year 2014, we are planning to hire 45 additional staff for DERA, primarily for additional financial economists and other experts to perform and support economic analyses and research and further enhance our risk assessment activities. In fiscal year 2015, we seek to add 14 positions in DERA, primarily financial economists and other experts who significantly assist with:
—The rulemaking process by providing the Commission and staff with economic analysis and technical advice;
—Data analysis for risk-based selection of firms and issues for inquiries, investigations and examinations; and
—Improving structured data initiatives in order to enable the Commission, investors, and other market participants to more systematically and efficiently analyze and draw conclusions from large quantities of financial information.

DERA also seeks to hire additional technologists with mathematical and statistical programming experience to support the activities of the Division, including by assisting with the development of risk assessment models and risk metrics, data analytics, and economic analysis in the agency's rulemakings.

ENHANCING MONITORING OF THE INVESTMENT MANAGEMENT INDUSTRY

In the past 10 years, the number of portfolios of mutual funds, exchange-traded funds, and closed-end funds has increased by 17 percent, and assets under management held by those funds has increased by 123 percent to $16 trillion. And significantly, during that period, complexity in the investment management industry has increased dramatically, reflecting growing sophistication in product design and portfolio strategies.

For fiscal year 2015, the SEC requests 25 new positions for its Division of Investment Management. With additional resources, Investment Management plans to:

—Improve the reporting of information about fund operations and portfolio holdings by mutual funds, closed-end funds, and exchange traded funds;

—Continue to build capacity to manage and analyze data filed by hedge funds and other private funds;

—Bolster the technical expertise of Investment Management's disclosure review program to, among other things, identify trends and monitor the risks related to the growth and increased product sophistication in the asset management industry; and

—Enhance the ability of Investment Management's Risk and Examinations Office to manage, monitor, and analyze industry data, and provide ongoing financial analysis of the asset management industry.

ENHANCING TRAINING AND DEVELOPMENT OF SEC STAFF

Nothing is more critical to the agency's success than the expertise of the SEC's staff. And providing in-depth and up-to-date training is essential for the staff to maintain and enhance its expertise over our constantly changing markets. Historically, the SEC's training budget has not matched that of its Federal financial regulatory agency peers. The agency is requesting to increase its staff training budget in fiscal year 2015 principally to support training and development for employees directly involved in examinations, investigations, fraud detection, litigation, and other core mission responsibilities of the SEC. This will consist of specialized training about new trends in the securities industry and changing market conditions, as well as analytics and forensics. The investment in training also will allow the SEC to provide continuing education courses that staff are required to take to maintain necessary legal and financial credentials.

CONCLUSION

Thank you for your support of the agency's vital mission and the opportunity to present the President's fiscal year 2015 budget request. I would be happy to answer your questions.

Senator UDALL. Thank you very much.

And Acting Chairman Wetjen, please proceed.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. MARK P. WETJEN, ACTING CHAIRMAN

Mr. WETJEN. Good afternoon, Chairman Udall, Ranking Member Johanns, and members of the subcommittee.

Thank you for inviting me today to the hearing on the President's fiscal year 2015 funding request for the Commission.

In my written remarks, I respond to the subcommittee's request to detail on how the Commission has used its resources in the previous 2 fiscal years. My goal this afternoon is to provide this subcommittee with context to the important role the Commission plays in the financial system and the economy as a whole, as well as the important role this committee plays in helping our agency achieve its mission.

As you know, the Commission was directed by Congress to police the derivatives markets, which includes futures, options, and swaps. The CFTC also has continued its effort to implement the new regulatory framework for the swaps market required under Dodd-Frank.

The operation and integrity of the derivatives markets are critical to the efficient functioning of the global financial system and the economies it supports. Without them, a farmer cannot lock in a price for his crop; a small business cannot lock in an interest rate that would otherwise fluctuate, perhaps raising its costs; a global manufacturer cannot lock in a currency value, making it harder to plan and grow its global business; and a lender cannot manage its assets and balance sheet to ensure it can continue lending. The derivatives markets better enable these enterprises to do what they do best—create jobs and grow the economy.

When not overseen properly, failures of firms or other irregularities in the markets can severely and negatively impact the economy and cause dramatic losses for individual participants. This is why appropriately funding the Commission is so important.

CFTC RESPONSIBILITIES

Measured in percentage terms, the Commission's funding level today is substantially larger than it was through much of the last decade. Previous funding increases were necessary and appreciated. Nonetheless, the growth of the Commission's responsibilities, including under Dodd-Frank, have significantly outpaced the growth in the agency's budget. Consequently, today the Commission is underfunded.

The markets the Commission oversees and the agency's related responsibilities have grown by a variety of different measures. For instance, the notional value of derivatives centrally cleared by clearinghouses was estimated to be $124 trillion in 2010 and is now approximately $223 trillion. That is nearly a 100 percent increase.

Now more than ever, a clearinghouse's failure to follow the Commission's regulations—designed to ensure proper risk management—could have significant consequences to the economy. The amount of customer funds managed by clearinghouses and futures commission merchants was $177 billion in 2010 and is now over $218 billion, a nearly 40 percent increase.

The Commission's rules are designed to ensure customer funds are safely kept by these firms, and a failure to provide appropriate oversight increases the chance of risky practices, placing customer funds at risk.

By one measure, the total number of registrants and registered entities overseen directly by the Commission has increased by at least 40 percent in the last 4 years. This includes 102 swap dealers, two major swap participants, and more than three dozen registered entities, which include clearinghouses and trading venues.

The CFTC also oversees more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures across financial markets. Additionally, the Commission directly or indirectly supervises approximately another 64,000 registrants, yet the agency's current onboard staff is just 648 employees.

The registered entities the Commission oversees are, by and large, well-run firms that perform important services for their customers. Nevertheless, those relying upon them, as well as the American public, deserve assurance that the risks the firms pose are being mitigated by an agency capable of meaningful oversight.

FISCAL YEAR 2015 REQUEST PRIORITIES

This year's budget request is a significant step towards a longer-term funding level that is necessary to fully and responsibly fulfill the agency's mission. It recognizes the immediate need for an appropriation of $280 million and approximately 920 full-time equivalents, which is heavily weighted toward examinations, surveillance, and technology functions. The request balances the need for more technological tools to monitor the markets, detect fraud and abuse, and identify risk and compliance issues with the need for expert staff to analyze and make use of the data.

PREPARED STATEMENT

Without additional funding, the consequences are plain: the Commission will be forced to perform fewer and less thorough examinations of registered entities, including those deemed systemically important or that steward customer funds; it will be less able to develop analytical systems to effectively perform surveillance of markets becoming increasingly automated; it will be deterred in its mandate to collect and analyze swaps data in an effort to enhance market transparency; and it will be less able to timely investigate and prosecute enforcement cases to address customer harm or threats to market integrity.

Thank you for inviting me today, and I will be happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF HON. MARK P. WETJEN

Good afternoon, Chairman Udall, Ranking Member Johanns and members of the subcommittee. Thank you for inviting me to today's hearing on the President's fiscal year 2015 funding request and budget justification for the Commodity Futures Trading Commission ("Commission" or "CFTC").

During the last 2 years, despite significant budgetary constraints, the CFTC has made important progress in fulfilling its mission. As you know, under the Commodity Exchange Act, the Commission has oversight responsibilities for the derivatives markets, which include futures, options, cash, and swaps. Each of these markets is significant. Collectively, they have taken on particular importance to the U.S. economy in recent decades and, as a consequence, have grown substantially in size, measuring hundreds of trillions of dollars in notional value. Their operation and integrity are critical to the effective functioning of the U.S. and global economies.

At their core, the derivatives markets exist to help farmers, producers, small businesses, manufacturers and lenders focus on what they do best: providing goods and services and allocating capital to reduce risk and meet Main Street demand. Well-regulated derivatives markets facilitate job creation and the growth of the economy by providing a means for managing and assuming prices risks and broadly disseminating, and discovering, pricing information.

Stated more simply, through the derivatives marketplace, a farmer can lock in a price for his crop; a small business can lock in an interest rate that would otherwise fluctuate, perhaps raising its costs; a global manufacturer can lock in a currency value, allowing it to better plan and grow its global business; and a lender can manage its assets and balance sheet to ensure it can continue lending, fueling the economy in the process.

Essentially, these complex markets facilitate the assumption and distribution of risk throughout the financial system. Well-working derivatives markets are key to supporting a strong, growing economy by enabling the efficient transfer of risk, and therefore the efficient production of goods and services. Accordingly, it is critical that these markets are subject to appropriate governmental oversight.

Mr. Chairman, Ranking Member, and subommittee members, I do not intend the testimony that follows to sound alarmist, or to overstate the case for additional resources, but I do want to be sure that Congress, and this subcommittee in particular, have a clear picture of the potential risks posed by the continued state of funding for the agency. When not overseen properly, the derivatives markets may experience irregularities or failures of firms intermediating in them—events that can severely and negatively impact the economy as a whole and cause dramatic losses for individual participants. The stakes, therefore, are high.

THE CFTC'S RESPONSIBILITIES HAVE GROWN SUBSTANTIALLY IN RECENT YEARS

The unfortunate reality is that, at current funding levels, the Commission is unable to adequately fulfill the mission given to it by Congress: to prevent disruptions to market integrity, protect customer assets, monitor and reduce the build-up of systemic risk, and ensure to the greatest extent possible that the derivatives markets are free of fraud and manipulation.

Recent increases in the agency's funding have been essential and appreciated. They have not, however, kept pace with the growth of the Commission's responsibilities, including those given to it under Dodd-Frank.

Various statistics have been used to measure this increase in responsibilities. One often-cited measure is the increase in the gross notional size of the marketplace now under the Commission's oversight. Other measures, though, are equally and perhaps more illustrative.

TRADING VOLUME HAS INCREASED

For instance, the trading volume of CFTC-regulated futures and options contracts was 3,060 million contracts in 2010 and rose to 3,477 million in 2013. Similarly, the volume of interest rate swap trading activity by the 15 largest dealers averaged 249,564 swap events each in 2010, and by 2012, averaged 332,484 each (according to the International Swaps and Derivatives Association ("ISDA") data). Those transactions, moreover, can be executed in significantly more trading venues, and types of trading venues, both here and abroad. In addition, the complexity of the markets—its products and sophistication of the market tools, such as automated-trading techniques—has increased greatly over the years.

CLEARING HOUSES MANAGE MORE RISK

The notional value of derivatives centrally cleared by clearing houses was $124 trillion in 2010 (according to ISDA data), and is now approximately $223 trillion (according to CFTC data from swap data repositories ("SDRs")). That is nearly a 100 percent increase. The expanded use of clearinghouses is significant in this context because, among other things, it means that the Commission must ensure through appropriate oversight that these entities continue to properly manage the various types of risks that are incident to a market structure dependent on central clearing. A clearinghouse's failure to adhere to rigorous risk management practices established by the Commission's regulations, now more than ever, could have significant economic consequences. The Commission directly oversees 15 registered clearinghouses and two of them, Chicago Mercantile Exchange, Inc., and ICE Clear Credit LLC, have been designated as systemically important by the Financial Stability Oversight Council.

CLEARING HOUSES AND INTERMEDIARIES MANAGE MORE CUSTOMER FUNDS

The amount of customer funds held by clearinghouses and futures commission merchants ("FCMs") was $177 billion in 2010 and is now over $218 billion, another substantial increase. These are customer funds in the form of cash and securities deposited at firms to be used for margin payments made by the end-users of the markets, like farmers, to support their trading activities. Again, Commission rules are designed to ensure customer funds are safely kept by these market intermediaries, and a failure to provide the proper level of oversight increases the risk of certain practices by firms, including operational risks or fraud. In fact, recent events in the FCM community led to the temporary or permanent loss of more than a billion dollars of customer funds.

SUBSTANTIALLY LARGER NUMBER OF FIRMS NOW REGISTERED WITH THE CFTC

The total number of registrants and registered entities overseen directly or indirectly by the Commission, depending on the measure, has increased by at least 40 percent in the last 4 years. This includes 102 swap dealers and two major swap participants ("MSPs").

In addition, the CFTC oversees more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures in and across multiple markets. It is conceivable that the failure of some of these funds could have spill-over effects on the financial system. In all cases, investors in these funds are entitled to know their money is being appropriately held and invested.

Additionally, the Commission directly or indirectly supervises another approximately 64,000 registrants, mostly associated persons that solicit or accept customer orders or participate in certain managed funds, or that invest customer funds through discretionary accounts. Although it leverages the resources of the self-regulatory organizations ("SROs"), the Commission itself must oversee these registrants in certain areas and provide guidance and interpretations to the SROs. The Commission does so with a total staff of only 648 employees currently onboard—about 1 percent of the number of registrants under its purview. Separately, the Commission must oversee more than three dozen registered entities, including clearinghouses and trading venues, each of which is subject to a complex set of regulatory requirements newly established or modified by the Dodd-Frank Act and designed to mitigate systemic risk.

By almost any measure, in fact, the portfolio of entities that the Commission is charged with overseeing has expanded dramatically in size and risk over the last half decade. The intermediaries in the derivatives markets are by and large well-run firms that perform important services in the markets and for their customers. Nevertheless, collectively, these firms can potentially pose risks—in some cases significant risks—to the financial system and the broader economy. Accordingly, those relying upon these firms and the public deserve assurance that such firms are supervised by an agency capable of meaningful oversight.

THE CFTC HAS MADE IMPORTANT PROGRESS BUT HAS BEEN SIGNIFICANTLY CONSTRAINED

For much of fiscal year 2013, the CFTC operated under continuing resolutions, which extended the fiscal year 2012 appropriation of $205 million. These appropriations, however, were subject to sequestration. Effectively, our operating budget for fiscal year 2013 was $195 million. Thus, the fiscal year 2014 appropriation of $215 million was a modest budgetary increase for the Commission, lifting the agency's appropriations above the sequestration level of $195 million that has posed signifi-

cant challenges for the agency's orderly operation. As directed by Congress, the agency has submitted a fiscal year 2014 Spend Plan outlining its allocation of current resources, which reflects an increased emphasis on examinations and technology-related staff.

Even with these significant budget constraints, the dedicated staff of the Commission were able to complete the majority of new rulemakings required by the Dodd-Frank Act—about 50 rulemakings in all. This was in addition to the Commission's ongoing work overseeing the futures exchange and options markets. These regulatory efforts resulted in greater transparency, which is critical to reducing systemic risk and lowering costs to end-users, while improving efficiency and supporting competition.

With regard to technology, we made progress in a variety of areas. We improved the quality of data reported to swap data repositories and have laid groundwork to receive, analyze and promulgate new datasets from SROs related to new authorities. We upgraded data analytics platforms to keep up with market growth. Financial risk surveillance tools were enhanced to support monitoring and stress testing related to new authorities. The Commission has prototyped a high-performance computing platform that dramatically reduces data analytics computation times and an on-line portal for regulatory business transactions to improve staff and industry productivity. The Commission has implemented enhanced position limit monitoring and is ready to implement pre-trade and heightened account ownership and control surveillance. Finally, the Commission has ensured that foundational server, storage, networking, and workstation technology are refreshed on a cost-effective cycle and that technology investments have cybersecurity and business continuity built-in.

In its role as a law enforcement agency, the Commission's enforcement arm protects market participants and other members of the public from fraud, manipulation and other abusive practices in the futures, options, cash, and swaps markets, and prosecutes those who engage in such conduct. As of May 1, 2014, the Commission filed 31 enforcement actions in fiscal year 2014 and also obtained orders imposing more than $2.2 billion in sanctions. By way of comparison, in fiscal year 2013, the Commission filed 82 enforcement actions, and obtained orders imposing more than $1.7 billion in sanctions.

With the bulk of rulemaking behind us, the necessary focus must be examinations, market supervision and enforcement. Simply stated, this requires appropriate staffing and technological resources sufficiently robust to oversee what are highly advanced, complex global markets, and be able to take effective and timely enforcement action.

THE FISCAL YEAR 2015 REQUEST PRIORITIZES EXAMINATIONS, TECHNOLOGY, MARKET INTEGRITY, AND ENFORCEMENT

The President's fiscal year 2015 budget request reflects these priorities and highlights both the importance of the Commission's mission and the potential effects of continuing to operate under difficult budgetary constraints.

The request is a significant step towards the longer-term funding level that is necessary to fully and responsibly fulfill the agency's core mission: protecting the safety and integrity of the derivatives markets. It recognizes the immediate need for an appropriation of $280 million and approximately 920 staff years full-time equivalents ("FTEs") for the agency, an increase of $65 million and 253 FTEs over the fiscal year 2014 levels, heavily weighted towards examinations, surveillance, and technology functions.

In this regard, the request balances the need for more technological tools to monitor the markets, detect fraud and manipulation, and identify risk and compliance issues, with the need for staff with the requisite expertise to analyze the data collected through technology and determine how to use the results of that analysis to fulfill the Commission's mission as the regulator of the derivatives markets. Both are essential to carrying out the agency's mandate. Technology, after all, is an important means for the agency to effectively carry out critical oversight work; it is not an end in itself.

In light of technological developments in the markets today, the agency has committed to an increased focus on technology. The fiscal year 2015 budget request includes a $15 million increase in technology funding above the fiscal year 2014 appropriation, or about a 42 percent increase, solely for IT investments.

In my remaining testimony, I will review three of the primary mission priorities for fiscal year 2015.

EXAMINATIONS

The President's request would provide $38 million and 158 FTEs for examinations, which also covers the compliance activities of the Commission. As compared to fiscal year 2014, this request is an increase of $15 million and 63 FTEs.

I noted earlier that the Commission has seen substantial growth in, among other things, trading volumes, customer funds held by intermediaries in the derivatives markets, and margin and risk held by clearinghouses. Examinations and regulatory compliance oversight are perhaps the best deterrents to fraud and improper or insufficient risk management and, as such, remain essential to compliance with the Commission's customer protection and risk management rules.

The Commission has a direct examinations program for clearinghouses and designated contract markets, and it will soon directly examine swap execution facilities and SDRs. However, the agency does not at this time have the resources to place full-time staff on site at these registered entities, even systemically-important clearing organizations, unlike a number of other financial regulators that have on-the-ground staff at the significant firms they oversee. The Divisions of Market Oversight and Clearing and Risk collectively have a total of 47 examinations positions in fiscal year 2014 to monitor, review, and report on some of the most complex financial market operations in the world.

The Commission today performs only high-level, limited-scope reviews of the nearly 100 FCMs holding over $218 billion in customer funds and 102 swap dealers. In fact, the Commission currently has a staff of only 38 to examine these firms, and to review and analyze, among other things, over 1,200 financial filings and over 2,400 regulatory notices each year. This staff level is less than the number the Commission had in 2010, yet the number of firms requiring its attention has almost doubled, and there has been a noted increase in the complexity and risk profile of the firms. Additionally, although it has begun legal compliance oversight of swap dealers and MSPs, the Commission has been able to allocate only 13 FTEs for this purpose. This number is insufficient to perform the necessary level of oversight of the newly registered swap dealer entities.

In fiscal year 2014, the Commission overall will have a mere 95 staff positions dedicated to examinations of the thousands of different registrants that should be subject to thorough oversight and examinations. The reality is that the agency has fallen far short of performance goals for its examinations activities, and it will continue to do so in the absence of additional funding from Congress. For example, as detailed in the Annual Performance Review for fiscal year 2013, the Commission failed to meet performance targets for system safeguard examinations and for conducting direct examinations of FCM and non-FCM intermediaries. The President's budget request appropriately calls on Congress to bolster the examinations function at the agency, and it would protect the public, and money deposited by customers, by enhancing the examinations program staff by more than 66 percent in fiscal year 2015.

Moreover, if Congress fully funds the President's request, the Commission can move toward annual reviews of all significant clearinghouses and trading platforms and perform more effective monitoring of market participants and intermediaries. Partially funding the request will mean accepting potentially avoidable risk in the derivatives markets as the Commission is forced to forego more in-depth financial, operational and risk reviews of the firms within its jurisdiction. Thus, the Commission would be reactive, rather than proactive in regard to firm or industry risk issues.

TECHNOLOGY AND MARKET INTEGRITY

The fiscal year 2015 request also supports a substantial increase in technology investments relative to fiscal year 2014, roughly a 42 percent increase. The $50 million investment in technology will provide millions of dollars for new and sophisticated analytical systems that will, in part, assist the Commission in its efforts to ensure market integrity. As global markets have moved almost entirely to electronic systems, the Commission must invest in technology required to collect and analyze market data, and to handle the unprecedented volumes of transaction-level data provided by financial markets.

The President's fiscal year 2015 budget request supports, in addition, 103 data-analytics and surveillance-related positions in the Division of Market Oversight alone, an increase of more than 98 percent over the fiscal year 2014 staffing levels. Market surveillance is a core Commission mission, and it is an area that depends heavily on technology. As trading across the world has moved almost entirely to electronic systems, the Commission must make the technology investments required

to collect and make sense of market data and handle the unprecedented volumes of transaction-level data provided by financial markets.

Effective market surveillance, though, equally depends on the Commission's ability to hire and retain experienced market professionals who can analyze extremely complex and voluminous data from multiple trading markets and develop sophisticated analytics and models to respond to and identify trading activity that warrants investigation. The fiscal year 2015 investment in high-performance hardware and software therefore must be paired with investments in personnel that can employ technology investments effectively.

Accordingly, to make use of existing and new IT investments, the fiscal year 2015 request would provide funding for 193 FTEs, an increase of 74 FTEs over fiscal year 2014. These new staff positions are necessary for the Commission to receive, analyze, and effectively surveil the markets it oversees. These new positions, together with the technology investments included in the fiscal year 2015 request, will enable the Commission to make market surveillance a core component of our mission.

The CFTC has invested appropriated funds in fiscal year 2013 and fiscal year 2014 in technology to make important progress. We have the groundwork in place to receive and effectively analyze swaps transaction data submitted to repositories and SROs related to new authorities. The fiscal year 2015 request would provide funding to continue and increase the pace of progress in the areas noted above and also support the additional examination, enforcement, and economic and legal staff. Effective use of technology is essential to our mission to ensure market integrity, promote transparency, and effectively surveil market participants.

ENFORCEMENT

The President's fiscal year 2015 request would provide $62 million and 200 FTEs for enforcement, an increase of $16 million and 51 FTEs over fiscal year 2014. The simple fact is that, without a robust, effective enforcement program, the Commission cannot fulfill its mandate to ensure a fair playing field. From fiscal year 2011 to date, the Commission has filed 314 enforcement actions and also obtained orders imposing more than $5.4 billion in sanctions.

The cases the agency pursues range from sophisticated manipulative and disruptive trading schemes in markets the Commission regulates, including financial instruments, oil, gas, precious metals and agricultural products, to quick strike actions against Ponzi schemes that victimize investors. The agency also is engaged in complex litigations related to issues of financial market integrity and customer protection. By way of example, in fiscal year 2013, the CFTC filed and settled charges against three financial institutions for engaging in manipulation, attempted manipulation and false reporting of London Interbank Offered Rate (LIBOR) and other benchmark interest rates.

Such investigations continue to be a significant and important part of the Division of Enforcement's docket. Preventing manipulation is critical to the Commission's mission to help protect taxpayers and the markets, but manipulation investigations, in particular, strain resources and time. And once a case is filed, the priority must shift to the litigation. In addition to requiring significant time and resources at the Commission, litigation requires additional resources, such as the retention of costly expert witnesses.

In 2002, when the Commission was responsible for the futures and options markets alone, the Division of Enforcement had approximately 154 people. Today, the agency's responsibilities have substantially increased. The CFTC now also has anti-fraud and anti-manipulation authority over the vast swaps market and the host of new market participants the agency now oversees. In addition, the agency is now responsible for pursuing cases under our enhanced Dodd-Frank authority that prohibits the reckless use of manipulative or deceptive schemes. Notwithstanding these additional responsibilities, however, total enforcement staff has shrunk—there are currently only 147 members of the enforcement staff. The President's budget request would bring this number to 200. More cops on the beat means the public is better assured that the rules of the road are being followed.

In addition to the need for additional enforcement staff and resources, the CFTC also believes technology investments will make our enforcement staff more efficient. For instance, the fiscal year 2015 request would support developing and enhancing forensic analysis and case management capabilities to assist in the development of analytical evidence for enforcement cases. In fiscal year 2013 and fiscal year 2014, appropriated funds invested in information technology have enabled the Commission to continue enhancing enforcement and litigation automation services, including a major upgrade to the document and digital evidence review platform that will

enable staff to keep pace with the exploding volume of data required to successfully conduct enforcement actions.

A full increase for enforcement means that the agency can pursue more investigations and better protect the public and the markets. A less than full increase means that the CFTC will continue to face difficult choices about how to use its limited enforcement resources. At this point, it is not clear that the agency could maintain the current volume and types of cases, as well as ensure timely responses to market events.

OTHER FISCAL YEAR 2015 PRIORITIES: INTERNATIONAL POLICY COORDINATION & ECONOMIC AND LEGAL ANALYSIS

The global nature of the derivatives markets makes it imperative that the United States consult and coordinate with international authorities. For example, the Commission recently announced significant progress towards harmonizing a regulatory framework for CFTC-regulated Swap Execution Facilitys (SEFs) and EU-regulated multilateral trading facilities ("MTFs"). The Commission is working internationally to promote robust and consistent standards, to avoid or minimize potentially conflicting or duplicative requirements, and to engage in cooperative supervision, wherever possible.

Over the past 2 years, the CFTC, SEC, European Commission, European Securities and Markets Authority, and other market regulators from around the globe have been meeting regularly to discuss and resolve issues with the goal of harmonizing financial reform. The Commission also participates in numerous international working groups regarding derivatives. The Commission's international efforts directly support global consistency in the oversight of the derivatives markets. In addition, the Commission anticipates a significant need for ongoing international policy coordination related to both market participants and infrastructure in the swaps markets. The Commission also anticipates a need for ongoing international work and coordination in the development of data and reporting standards under Dodd-Frank rules. Dodd-Frank further provided a framework for foreign trading platforms to seek registration as foreign boards of trade, and 24 applications have been submitted so far.

Full funding for international policy means the Commission will be able to maintain our coordination efforts with financial regulators and market participants from around the globe. If available funding is decreased, we will be less able to engage in cooperative work with our international counterparts, respond to requests, and provide staffing for various standard-setting projects. The President's fiscal year 2015 request would enable the Commission to sustain its efforts, providing $4.2 million and 15 FTEs that would be dedicated to international policy.

In addition, for fiscal year 2015, the President's budget would support $24 million and 92 FTEs to invest in robust economic analysis teams and Commission-wide legal analysis. Compared to the fiscal year 2014 Spending Plan, this request is an increase of $4 million and 18 FTEs. Both of these teams support all of the Commission's divisions.

The CFTC's economists analyze innovations in trading technology, developments in trading instruments and market structure, and interactions among various market participants in the futures and swaps markets. Economics staff with particular expertise and experience provides leverage to dedicated staff in other divisions to anticipate and address significant regulatory, surveillance, clearing, and enforcement challenges. Economic analysis plays an integral role in the development, implementation, and review of financial regulations to ensure that the regulations are economically sound and subjected to a careful consideration of potential costs and benefits. Economic analysis also is critical to the public transparency initiatives of the Commission, such as the Weekly Swaps Report. Moving into fiscal year 2015, the CFTC's economists will be working to integrate large quantities of swaps market data with data from designated contract markets and swap execution facilities, and large swaps and futures position data to provide a more comprehensive view of the derivatives markets.

The legal analysis team provides interpretations of Commission statutory and regulatory authority and, where appropriate, provides exemptive, interpretive, and no-action letters to CFTC registrants and market participants. In fiscal year 2013, the Commission experienced a significant increase in the number and complexity of requests from market participants for written interpretations and no-action letters, and this trend is expected to increase into fiscal year 2015.

A full increase for the economics and legal analysis mission means the Commission will be able to support each of the CFTC's divisions with economic and legal analysis. Funding short of this full increase or flat funding means an increasingly

strained ability to integrate and analyze vast amounts of data the Commission is receiving on the derivatives markets, thus impacting our ability to study and detect problems that could be detrimental to the economy. Flat funding also means the Commission's legal analysis team will continue to be constrained in supporting front-line examinations, adding to the delays in responding to market participants and processing applications, and hampering the team's ability to support enforcement efforts.

CONCLUSION

Effective oversight of the futures and swaps markets requires additional resources for the Commission. This means investing in both personnel and information technology. We need staff to analyze the vast amounts of data we are receiving on the swaps and futures markets. We need staff to regularly examine firms, clearinghouses, trade repositories, and trading platforms. We need staff to bring enforcement actions against perpetrators of fraud and manipulation. The agency's ability to appropriately oversee the marketplace hinges on securing additional resources.

Thank you again for inviting me today, and I look forward to your questions.

Senator UDALL. Thank you both for your testimony.

And we will now proceed on 7-minute rounds of questions.

CFTC MISSION ACTIVITIES

Chairman Wetjen, the CFTC's budget justification submitted to the committee suggests that the fiscal year 2015 request, and I quote from that budget justification, "A significant step towards the longer-term funding level that is necessary to fully and responsibly fulfill the agency's core mission."

What do you consider to be the optimum funding level necessary for the CFTC to fully and responsibly perform its work? What functions would the CFTC not be able to adequately address if the funding level enacted for 2015 is less than the full $280 million requested?

Mr. WETJEN. Thank you, Chairman, for the question.

This request is especially focused on three key areas for the agency and with regard to the agency's mission. The key mission activities are enforcement, surveillance, and examinations. And as I just said in my opening statement, we are not going to be able to do as much as we should, I believe, in each of those three key areas.

So we are not going to be able to do as many examinations of some of these critical entities and intermediaries in our marketplace. I mentioned clearinghouses. There is a tremendous and enormous amount of risk that is now being housed at clearinghouses. That has increased quite substantially in recent years. We have 15 clearinghouses under our jurisdiction, and we are able to annually examine 2 of them which have been deemed systemically important.

We have, with current staffing, been able to get around to some of the other clearinghouses as well, but we are not in a position with the current staffing to examine all 15 of those on a regular basis. So the staff has been forced to make judgments about which clearinghouse might be a little more risky than others and focus attention in that way. And I think ideally—again, just focusing on the category of clearinghouses—you would have examinations of all of them on an annual basis.

Senator UDALL. How about the optimum level? Do you have a thought on that?

Mr. WETJEN. Well, the $280 million request I think gets us very, very close to optimal, based on my judgment. The request this year is slightly below what was asked for last year.

Primarily that was because we wanted to be respectful of the direction the Congress gave us in passing the budget resolution, which called for a very modest increase in overall discretionary spending. So in light of that, it seemed appropriate to adjust the request this year accordingly.

Senator UDALL. Thank you.

Chair White, the SEC is seeking $1.7 billion for fiscal year 2015. This would be a 26 percent increase in resources compared to the level enacted for the current year.

KEY PRIORITIES FOR THE SEC

What are the top priorities to which these additional resources will be devoted? What consequences can be expected if the funding level approved for the SEC is less than the amount requested by the President?

Ms. WHITE. The priorities are to fund our exam program, our enforcement program, our—really, our core areas, including our Division of Economic and Risk Analysis.

IMPORTANCE OF SUFFICIENT SEC FUNDING

I don't think we can overstate the importance of sufficient funding, what we request in this budget request, for technology. We are at a critical juncture at the SEC with a number of our systems enhancements, a number of our risk-based tools that allow us to be smarter and more efficient in detecting problems in the marketplace, including emerging frauds.

Just as an illustration, I alluded to this in my oral testimony as well—there are 11,000 registered investment advisers now under the SEC's jurisdiction. And under current levels, we were only able to cover 9 percent of those last year. And that is using very smart, targeted, risk-based tools to go to the areas where we think the highest risk is.

But there are 40 percent of those investment advisers who have not been examined. So that is a very, very high priority for us, as it was in the 2014 request, but we did not actually receive funding for that.

Strong enforcement of our Federal securities laws is always at the top of our highest priority list, along with others. And this budget request does seek 126 additional enforcement staff, including market experts, which I think is enormously important to do our job better and more efficiently.

So if we were not to receive funding at that level, clearly all of our functions really across the board would suffer. I have tried to illustrate the areas of greatest need, and certainly our request is intended to be quite targeted and surgical to those core needs.

We obviously have the new responsibilities that you alluded to in your opening remarks to implement the reforms in the over-the-counter securities-based swap markets. We have new advisers we are responsible for. All of that needs to be implemented as well as, obviously, the rules put in place.

WALL STREET REFORMS

Senator UDALL. Thank you.

In a couple of months, we will mark the fourth anniversary of the enactment of comprehensive Wall Street reforms aimed at strengthening the oversight in the wake of the financial crisis of 2008. And recent analysis by outside monitoring entities reflect that of the 398 total rulemakings required under Dodd-Frank, 95—24 percent—are under the jurisdiction of the SEC, and 60—15 percent—are under the jurisdiction of the CFTC.

A report by Davis Polk analysts issued last month indicates that of the 95 rules under the SEC, 42—that is 44 percent—had been finalized, and 10—11 percent—have not yet been proposed. Of the 60 CFTC rules, 50—83 percent—have been finalized, and 3—5 percent—have not yet been proposed.

Both of you, I am interested in hearing how the independent progress reports square with your agency's own internal tracking of your implementation timetable. I think the best thing for me to do is come back to that question, let Senator Johanns question, because I have a couple of additional questions on that. And if you can keep that in mind, I may end up repeating some of that.

Senator Johanns, I am going to go to you for questioning at this point.

BUDGET INCREASE REQUEST

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman Wetjen, let me get started with you. If you look at the Budget Control Act and then the Ryan-Murray agreement that was reached last fall after, as you know, some very, very difficult negotiations, total discretionary spending is due to increase this year by about $1.4 billion—or in the next budget year, I should say. That is less than 1 percent increase over last year.

So I think the bipartisan message sent to everybody is that this is going to be very tight, very challenging, very difficult. However, in the budget request we get from CFTC, you are asking for a 30 percent increase.

Now, I think by anybody's definition that is significant. But it is especially high when you recognize what everybody else is faced with across the Federal Government.

So I would ask you a couple questions. One is how do you justify it, recognizing that colleagues across the Federal Government with very important missions like yours are also going to be held to this agreement?

And then, second, what if it doesn't happen? Do you have contingency plans as to how you will deal with that and how you will get your budget in line with what the Ryan-Murray agreement calls for?

Mr. WETJEN. Thank you, Senator, for the question.

The request was based on a number of different factors. But first and foremost, what are we responsible for doing under the law? And again, I will go back to the three key areas of our agency's mission—enforcement, surveillance, and examinations.

Those are the key mission activities. But meanwhile, the number of entities we oversee has increased by a variety of different meas-

ures that I just recently went through in percentage terms that are even higher than the percentage increase we sought with our budget request this year.

And so, I think our first responsibility—or my first responsibility in my capacity at the moment is trying to make my best judgment and best case for the kind of funding we need to make sure we are complying with the law. And so, that formed the basis of this.

And as I said before, we recognize the passage of the budget agreement last year, and so we tried to be more modest this year in the request. But we have to make sure that we are executing on these key mission activities. Otherwise, I worry that we are not fulfilling our responsibilities to the American public.

There is quite a bit at stake. As I tried to lay out in my testimony, there are enormous amounts of risk being managed by the firms that we oversee. That is why we have fulsome rule sets that they are required to comply with. It is primarily for that purpose, to make sure they are managing risk in an appropriate way.

And unfortunately, we have seen over the past number of years the sorts of outcomes that can happen when they fail to do that or when they fail to follow our rules. So that is the basis for the request.

Your second—remind me again, Senator, the second part of your question.

Senator JOHANNS. The second part of the question is what if you don't get there? How are you going to——

Mr. WETJEN. Right.

Senator JOHANNS [continuing]. Describe for us how you are going to deal with that if your argument isn't adopted and your request isn't granted?

Mr. WETJEN. Well, I think we will have to continue doing—we would be forced to continue doing what we have been doing. And that is using our best judgment about which entities to examine, which ones we are going to have to take a pass on in a particular year, make judgments about which matters to pursue by way of investigations once some incident comes to light, whether by referral from another division within the agency or through some other way outside of the agency. Judgments will be have to made there—be made there.

And as far as those cases that are already under development, enforcement cases under development, again, judgments will have to be made about how to allocate resources. Do we devote more to some cases based on, you know, certain risks of success or risk of not succeeding, and so it might involve an assessment of litigation risk in that way.

So these are the sort of judgments you prefer not to have to make, given the responsibilities we have been given under the law.

TECHNOLOGY SPENDING

Senator JOHANNS. In this general vein, let me ask a question about the technology piece of your budget.

CFTC technology spending has grown less than 7 percent since fiscal year 2011. The overall budget is up by 12 percent during that same period of time. My concern is that the CFTC is operating

with Selectric typewriters while the industry is operating with the latest technology, and I just worry that you are getting behind.

It seems to me that what we are trying to achieve with your agency is a faster, more technological advanced agency than we have today that can keep up with what is going on in the marketplace. Not necessarily a bigger agency. Bigger doesn't necessarily solve the problems that you are dealing with out there.

So tell us why the Commission has, it seems to me, downplayed technology investment while spending in other areas of the budget. It would seem to me technology would be critical for you to keep up.

Mr. WETJEN. Sir, you are absolutely right. It is critical. And by no means should this year's request be viewed as downplaying the importance of technology. It is critically important.

But what we have had to do, again, is given the fact that there are finite resources and trying to be responsible in our request and in light of other responsibilities of the agency, we just had to make a judgment about how much is appropriate to allocate to technology spending right now and how much is appropriate to spend on these other important mission activities.

And as important as technology is, we still need human capital to use it and deploy it. And as important as technology is, we need to be doing our level best on these key functions such as examinations.

And I hate to beat this drum continually, but these entities that we oversee are critically important, and the amount of risk that they house is very, very significant. And some of these intermediaries also manage billions and billions of dollars of customer money, and we have seen instances of FCMs, they are called, fail in the last number of years.

And in the case of MF Global, we had more than $1.5 billion tied up in a bankruptcy proceeding. Now there is a variety of different reasons why MF Global failed, but the point is oversight is important, and the rules we have are designed to prevent that sort of incident from taking place.

So $50 million is a slight increase, as you said, above where we have been spending currently. I would like to spend much more than that. But in the context of an overall budget request that has limitations, that was my best judgment about where we should be in the short term.

Senator JOHANNS. Mr. Chairman, I will yield back to you. And I anticipate another round?

Senator UDALL. Yes, yes. Of course. Thank you, Senator Johanns.

STATUS OF MANDATORY RULEMAKING

I outlined a little bit on that Davis Polk analysis and the numbers there. And going back to that question, how the independent progress report squares with your agency's own internal tracking of your implementation timetable. Yes? For both of you.

Ms. WHITE. Essentially, yes, whether the particulars match up precisely, essentially, they do. I mean, the SEC, as you mentioned in your opening remarks, was given nearly 100 rulemakings by

Dodd-Frank, and then some additional ones under mandated rulemakings and then additional ones under the JOBS Act.

And I did from the beginning of my tenure and continue to prioritize the completion of those rulemakings under both Dodd-Frank and the JOBS Act. And I am pleased with the progress. We have proposed or adopted about over 80 percent, but we clearly have a ways to go.

Among those that we have adopted and proposed since I have been at the agency for about a year now, I think there are 20-quite significant ones. Among those adopted, the Volcker rule is obviously one of them. The bad actor rule, which is very important to investors, specifies that certain offerings should not be exempt if they are associated with bad actors.

We have proposed all of the title VII rulemakings under our jurisdiction and adopted some. It is a very high priority for 2014 for us to complete those. We have adopted the municipal advisors rule. A number of others have been adopted. And again, we have completed nearly all the mandated studies that were assigned to us under Dodd-Frank.

It is very important that these rulemakings are done, obviously, promptly—and that is certainly one of my commitments and one of the commitments I made at my confirmation—but also to be done well and to be done after careful and appropriate economic analysis. And so, you know, we are all very closely focused as one of our highest priorities on completing those mandated rulemakings under the Dodd-Frank Act and under the JOBS Act.

STAFFING EXPERTISE

Senator UDALL. Do you feel you have the necessary expertise on staff to adequately issue and enforce the rules required by Dodd-Frank?

Ms. WHITE. I think we have the necessary expertise on staff. Obviously, some of our rulemakings are also done jointly or in consultation with our fellow regulators, both domestically and internationally.

But you make an excellent point, which is what we are talking about is not just adopting those robust, strong rules, but also then implementing them following their adoption. And that is one of my significant resource concerns, that we actually do have the resources to adequately and robustly implement and enforce those rules once they are adopted.

Senator UDALL. And do you have staffing plans adapted to bring on more expertise in areas that contributed to the financial crisis?

Ms. WHITE. Again, a very high priority of mine since I began was to bring on more experts, including economists. So you will see that prioritized in our budget again this year as it was last year with expertise certainly in areas that were involved in the financial crisis and also in modern-day issues with respect to our equity market structure.

And we have done that in the enforcement space as well. So there is full understanding of the rules we are enforcing with the requisite expertise. And that is one of the very important things that we are seeking the funding for in this budget request.

RULEMAKING

Senator UDALL. Chair Wetjen, how are you coming on the rules that you are promulgating, the ones that are in the pipeline? Does it square pretty much with the independent analysts, or do you take issue with their numbers?

Mr. WETJEN. No, I believe it does. The primary rulemakings that come to mind when I think about those that we were required to do under Dodd-Frank but have not yet finalized, it is the rulemaking for margin requirements for uncleared swaps, capital requirements for those firms entering into uncleared swaps, and then the third one would be a final rule on position limits, another rulemaking required under Dodd-Frank.

So I believe that Davis Polk study had the same count—they might have mentioned one more, I believe you said. But those are the three that I think of in terms of unfinished business.

On position limits, we proposed a rule there last fall. So staff is working on the common file, creating a response to that proposal.

On the other two, staff is working on a re-proposal. Those were rulemakings that were actually proposed a couple of years ago. But in light of significant international work done through the auspices of a number of different key international organizations, the decision was made to actually re-propose the rule, those two rules. And so, we hope to have something in circulation for the Commission very, very soon on those two.

Senator UDALL. Now how would you characterize the efforts to harmonize rules among multiple regulators? Why don't you take a stab at that.

Mr. WETJEN. Thank you sir.

It is difficult. It is—everyone has their own responsibilities and obligations to their own country and to their own legislative bodies. But there has been considerable effort through some of these same international organizations I mentioned. The International Organization of Securities Commissions (IOSCO) is a key one that comes to mind.

There is another group that was formed specifically related to derivatives reforms, the OTC Derivatives Regulators Group (ODRG) it is called. And so, those groups meet on a regular basis all in an effort to try and get countries to adopt reforms that are sufficiently comparable and comprehensive in nature.

Senator UDALL. Chair White.

COORDINATION IN RULEMAKING

Ms. WHITE. Yes. I think, again, a high priority we have both domestically and internationally is to try to—even on rulemakings that are not required to be joint, ensure that there is very close consultation and coordination to try to make them as robust, but as consistent or at least compatible as possible really around the globe.

When you talk about the title VII rulemakings and the over-the-counter derivatives market, that is obviously a uniquely global market. And so, we need to get that right. And I think we are all working very hard to try to do that.

I think the fact that the agencies charged with implementing the Volcker rule actually worked together and came out with a joint rule, including the CFTC and the SEC, was enormously important, both to the strength of the rule and the consistency and certainty for the marketplace.

Senator UDALL. Thank you.

Senator Moran, would you like to——

Senator MORAN. Mr. Chairman, thank you very much.

Senator Johanns was—this may be based upon the relationship I have had with other CFTC chairmen—telling me that the presumption exists that if you are a Creighton grad, you can do no wrong.

Chairman Wetjen, thank you very much for joining us today. I appreciated the conversation that we had in my office yesterday. You have indicated to me, and I have seen evidence of it, the desire to work hard to develop good, solid relationships with Congress, and I am very grateful for that. I look forward to accomplishing that as well with you. Let me just ask a question that in part we discussed yesterday.

Implications of rulemakings mandated by Dodd-Frank. What are you able to do to mitigate what is always described as unintended consequences? You and I have been in touch in regard to a real-time reporting rule, which may unintentionally identify swap participants in transactions, and you indicated this is something you are looking into.

Would you bring me up to date? And maybe can put on the record the conversation—the nature of the conversation we had yesterday and where you are headed.

REPORTING TRADES

Mr. WETJEN. Thank you, sir.

We did pass a rulemaking that puts in place a real-time reporting obligation of swaps activity. And depending on the entity or the counterparty in the trade, there is a timeline by which the party has to report their trade to the public.

And the matter you and I discussed, as you know, relates to certain instruments that are not terribly liquid, meaning there is not a lot of trading activity in some of these products. And because of that fact, it becomes easier to identify the identity of one of the counterparties.

And so this is a problem and a challenge for the agency because the statute does say one of the considerations that has to be made is that in this reporting obligation, the identity of the party not be revealed. On the other hand, there is tremendous public benefit in having information about a trade available as quickly as possible. That is very useful in terms of price discovery, which is one of the key functions of our marketplace.

So that is where the tension is. And so, I have directed the staff at the CFTC to examine this problem, to look into it, and to see whether or not we can confirm that this is, in fact, a problem.

The other analysis here is, again, I think we need to review what the statute says and look carefully at that and determine what was meant when we were cautioned not to have a reporting obligation that could reveal someone's identity. It is not like anyone said,

"Hey, it is so and so." But just that, again, so few people are trading in a particular instrument that the marketplace tends to figure out relatively easily who those parties are.

So staff is looking at this. I actually had a conversation after you and I spoke yesterday, a follow-up conversation with the staff. They are doing a new type of analysis that I wasn't aware of when you and I spoke. So they are looking at another way to see if they can confirm some of what has been reported by the parties in these particularly illiquid swaps. So we will keep looking at it and keep you up to date.

FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS

Senator MORAN. Thank you very much.

Let me turn to the SEC. Chair White, thank you very much for your presence today. I am pleased to see you here, as I sometimes do in the Banking Committee as well.

Two asset managers were recently graduated to Stage 2 of the Financial Stability Oversight Council (FSOC's) review process for systemically important financial institutions. And I am concerned that asset managers who simply administer customer accounts may be proceeding down a path of additional regulation that, in my view, may be inappropriate for that industry.

Can you give me a better sense of how this designation process for asset managers is progressing at the FSOC, and given the understanding that the assets in question are not owned by the companies in question? And then I have a couple of follow-ups, I think, based upon what you say.

Ms. WHITE. I think although there have been media reports to the effect of your question, I don't think there has been a public announcement of the precise status, if any, with respect to specific asset managers, which is the protocol of the FSOC with respect to any company that might be considered.

Senator MORAN. That is encouraging. Because what I would ask you is—because I understand there is a roundtable discussion to occur in the next couple of weeks. And so, part of my concern is why are we making designations now when there is more work yet to be done?

Ms. WHITE. Well, again, I think that FSOC officials—the Secretary of Treasury, obviously, the chair of the FSOC—are engaged in a process of learning about and gathering data on the asset manager industry. Again, I can't go beyond what I can say publicly about the process otherwise.

I think it is a good development that there is the asset manager conference on Monday, and it is a public forum, so that the representatives of the FSOC, staff of the member agencies will hear from the industry and other interested parties and knowledgeable parties.

I do think it is important—and again, the FSOC is given the responsibility to decide whether there are systemically important institutions that aren't banks, are insurance companies, et cetera. And if so, if they pose systemic risk to the financial system, one of the powers Congress gave to FSOC was to designate.

Now that doesn't say what that process should be, what the data should be before one does that. I think those are very important

questions. And I think it is also very important—and actually, the OFR study, which came out in September about the asset management industry, not specific parties, pointed out the very fact that you mentioned, which is the asset manager business is an agency business.

And so, when you are considering what, if any, systemic risk it may or may not pose, you are not talking about a balance sheet of positions. You are talking about an agency model. And I think it is very important that that be understood by all who are considering this and that the right expertise be brought to bear on that analysis.

SIGNIFICANCE OF AGENCY RELATIONSHIP IN FSOC DESIGNATIONS

Senator MORAN. In your analysis, what is the significance of that agency relationship? How do you personally, or how do you at the SEC as chair, see this issue within your role at FSOC?

Ms. WHITE. Well, again, as the Chair, I am a member of FSOC, as you know. I think it is an extremely important factor.

Essentially, if you are looking to what kinds of entities and why they may create systemic risks, if these assets are not yours and not on your balance sheet, that is a very different situation before you to assess in terms of whether such an entity, if it were to fail, fails in any sense similarly to a bank, which does carry positions on the balance sheet, obviously.

So I think it is a critical fact. Not the only fact to look at, but a critical distinction between asset managers and some of the other entities that have been considered.

Senator MORAN. Thank you both. My time has expired.

Senator UDALL. Senator Johanns.

CHANGES MADE AT THE SEC

Senator JOHANNS. Chair White, if I could turn to you. If you look at the history of the SEC budget, even predating the Obama administration going back to the year 2000, the budget has grown from $377 million to $1.35 billion in 2014, very, very significant growth by any definition.

But despite this tremendous growth in resources, the SEC—and I acknowledge this was prior to your time. But it failed to detect Ponzi schemes like Madoff, Stanford; didn't sound the warning on the collapse of the U.S. financial system—or near collapse. That describes for me a very serious problem within the SEC. You may disagree with that. You may agree with that.

But I would like you to spend some time, since this is a great opportunity for oversight, to talk to us on the committee about your view of what needs to be done to avoid a future Madoff, a future Ponzi scheme.

What are you doing at the SEC that changes the culture of that dynamic of how people look at their role and responsibility in terms of dealing with characters like that and in terms of dealing with the financial system of the United States?

SEC ENHANCEMENTS AND IMPROVEMENTS

Ms. WHITE. I think several points there. One is—and the agency has obviously acknowledged this—that there were weaknesses and issues where before my arrival the agency had made significant progress on addressing, and very important that that did happen, I think.

For example, in terms of a Ponzi scheme, today one of the items in our budget request that we are seeking to enhance even further is the tips, complaints, and referral system whereby we get about 15,000 complaints at the SEC every year. Three thousand plus of those come into our whistleblower office, but 15,000 in toto, so to speak. And so, those are now all centralized, automated, assessed electronically, quickly, and sent out to where they need to be sent out.

One of the enhancements that we actually weren't able to do last year because of the funding was to automate the triaging of those complaints. But there is no question that that feature, which did figure in those incidents you are mentioning, is now quite, quite different at the SEC.

A number of other changes were made, both in the exam program—enhancement, improvements—and in the enforcement division as well. I mean, one of the things that I think is enormously strengthening the enforcement program, for example, is the specialty units, where you now have expertise residing in different market strata that the SEC is responsible for. And again, I think nothing is more important at the SEC than to have a very strong compliance function, very strong enforcement function.

On the examination side, also enhancements, improvements have been made, really very significant ones. We have been helped by our technology there. We have been helped by our economists as part of that effort, which is basically that we now have technological tools that allow us to analyze, assess, and access massive amounts of data much more quickly.

For example, one of our newer tools in the examination program is called NEAT, which is National Exam Analytics Tool. Basically, it allows our examiners when they go in to an investor adviser to examine, to look at all of their trading.

And so, we have one instance recently where I think 17 million transactions were accessed and analyzed in 36 hours. The SEC of yesterday couldn't have come close to that.

And what do we do when we get that data analyzed? We look for patterns of insider trading. We look for Ponzi schemes. We look for front running. We look for other kinds of patterns that may suggest wrongdoing.

So it is a much stronger SEC in those respects, I think. No one could responsibly sit here and say that any law enforcement agency will never miss a scheme going forward. But it is an extraordinarily strong enforcement and exam function today.

PREVENTION OF ANOTHER MADOFF

Senator JOHANNS. Would you be confident in testifying to the subcommittee today that under the current atmosphere, the cur-

rent approaches, that Madoff could not repeat what he did some years ago?

Ms. WHITE. From what I know of what occurred—and again, I wasn't here, but I have studied what occurred. I think the systems we were just talking about, among others, certainly at the SEC, I believe that activity would have been detected and proceeded upon.

Again, you can never guarantee that you will catch every Ponzi scheme, every fraudster, every criminal in any agency. But I do think it has been built to prevent that from happening again.

SEC'S ABILITY TO USE FUNDS IN AN ABBREVIATED TIME PERIOD

Senator JOHANNS. The budget request you are making this year admittedly is sizeable. I appreciate you are a little bit different circumstance. But having said that, it is our job to provide oversight wherever the dollar comes from.

Given recent past experience, history would probably tell us that we might be facing a continuing resolution and that you would not receive your full request for some period of time into the budget year. We haven't done a lot of budgets around here, unfortunately. Consequently, what would then happen is your budget request may be met in January, February, March of next year.

Under those circumstances, would you in that limited period of time, between when you received that and the end of the fiscal year—the end of September 2015, would you be able to responsibly deal with that? Hire up the people you want to hire up, do the things you want to do, within an abbreviated period of time?

PRUDENT SPENDING

Ms. WHITE. I think there is no question, and we have done this in prior years as well. We take into account the likelihood of a continuing resolution, and how long it may last. And that clearly leads to prudent deferred spending. We do have no year funds, however, so that we are able to more flexibly deal with getting our money somewhat later in the year.

But there is no question. One place where it is a particular challenge is in our long-term mission-critical information technology (IT) projects. I mean, for those of necessity, you need to know you have the money. And then there is a relatively lengthy procurement process. So they do present challenges.

But I think our financial management folks, and I have talked at length to them about these issues as well, are geared up to be able to use if we would get the funding, as much of it as is possible. And then they can carry over and be able to use the funding in the following year, but having projected the uses for it in this year.

Senator JOHANNS. I yield, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns.

And thank you for those answers.

VOLCKER RULE

I wanted to shift over to the Volcker rule, which you all know is a very, very important one. Chair White and Chairman Wetjen, on September 10, 2013, five Federal financial regulatory agencies issued uniform final regulations implementing the Volcker rule.

The first question. How is the Volcker rule being enforced, and what is the relevant role of each of your agencies in overseeing compliance?

Ms. WHITE. I think the rule itself actually became effective April 1 of this year. But the compliance period is still out into 2015 and beyond that. It is a scaled compliance approach, both in terms of extent and also in terms of timing.

And again, I think I alluded to this a few minutes ago, it is critical that the agencies did enact a joint rule. I think it is a better rule, a stronger rule, and it plainly for the marketplace was necessary to do that.

And one of the commitments, and I actually said this in my opening statement when the SEC adopted the rule, is that we need to be focused from this day forward on continuing that coordination as we get into the compliance and enforcement period.

And so, there is an interagency working group that all five agencies have very active senior members on who are focused on questions of interpretation, questions of compliance, questions of enforcement. And we will try to stay as consistent and in sync as we can. We are obviously independent agencies at the end of the day.

With respect to entities who are covered by the rule—for example, broker-dealers—the SEC is the primary regulator there. And so, we will have the voice as to whether there is compliance or not and proceed with enforcement, but we will still coordinate with each other on questions of interpretation that affect compliance and enforcement.

AGENCY COORDINATION

Senator UDALL. Chair Wetjen, do you have thoughts on that?

Mr. WETJEN. I would like to echo what Chair White said. I think there is a continued commitment to coordinating among the agencies.

Another good example, in addition to what Chair White shared, is we actually issued an interim final rule, I believe that was late January, and it related to a special investment vehicle issue that materialized and had come to the attention of the agencies and to the Congress. And so, all five agencies adopted this interim final rule very, very rapidly.

And again, I just think that is another example that there is a continued commitment to solve these problems jointly, again, in an effort to avoid any kind of uncertainty that not doing so could create for the marketplace. So I expect that to continue.

MONEY MARKET MUTUAL FUNDS

Senator UDALL. Shifting now to money market mutual funds. Chair White, as you know, Senator Johanns and I and several other Senators wrote to you at the SEC in 2012, highlighting the concerns raised by our local governments on changes to money market mutual funds. And I keep hearing from folks back home about this issue.

In fact, a little over 2 weeks ago, I had a conference call with constituents representing local governments and businesses in New Mexico, and they continue to express concern about possible changes. As you know, local governments rely on these money mar-

ket mutual funds as a cash management tool and as an important source of low-cost, short-term financing.

Can you give us an update on where the SEC is on the rule? And how do you plan to address these concerns of local governments and others?

Ms. WHITE. Yes. The SEC commissioners and staff are actively involved, quite actively involved in finalizing those rules and those reforms of money market funds. They are a priority for 2014. I expect in the relative near term to proceed to finalizing those rules.

As you know, when we proposed the rules, we proposed two alternatives. One is a floating net asset value (NAV) for prime institutional funds and the other a fees and gates approach. Government funds were actually exempted from the floating NAV, but municipalities weren't. I think that is the issue that is being raised.

We have gotten a lot of comments on precisely that point. The staff has met with a number of representatives of municipalities expressing that concern. Should we go in that direction of a floating NAV, there is an exemption for retail funds, which would cover some of the municipal funds, but I think not all. We are very carefully focusing on all of the comments, but quite focused on the concern that has been expressed by the municipalities.

Senator UDALL. Right. Thank you very much.

Senator COONS. Welcome. Good to have you here.

IT FUNDING

Thank you. I appreciate the opportunity to join you and thank you both for your service and for the opportunity to discuss with you your proposals.

If I might first ask CFTC Chair Wetjen, the core to your funding request is about investments in technology and staff. And your fiscal year 2015 request calls for a $15 million increase in IT funding.

Could you just comment on the risks posed to your organization, on the markets if your IT infrastructure isn't upgraded or modernized, and what role it plays in your taking on an expanded role?

Mr. WETJEN. Thank you, Senator Coons.

We have a plan developed by our Office of Data and Technology on how to use the $50 million. It would include some enhancements to current systems we have in place which are necessary for surveillance purposes.

And the one system I would point out is one that tries—well, tracks positions taken on by market participants. And so, it is a critical tool that we have now, but it still needs to be enhanced if it is going to be as effective as possible.

Going forward, I think what the agency should consider doing is investing in new initiatives, technological initiatives so that we can get a better understanding of not only consummated trading activity, but order messaging, which is something that happens a lot in automated markets.

You have firms or entities sending in orders that don't always match with another counterparty. So it is important because some firms inappropriately might use a number of different order messages sent into a marketplace as a way to engage in some kind of a manipulative scheme. And so, going forward, you know, if we are

able to get additional funding for IT, I think that is the next key initiative we might want to invest in.

CFTC ENFORCEMENT ACTIONS

Senator COONS. You had a budget of roughly $200 million last year and collected north of $1.7 billion in fines. That is about an eightfold return on taxpayer investment. So I just wondered if you wanted to take a moment and explain, as an entity that literally pays for itself, what enforcement actions you pursued last year and how a more fully funded CFTC would benefit taxpayers, as well as benefit the marketplace.

Mr. WETJEN. Yes, thank you, Senator, for that question.

I think we initiated and completed around 150, 160 enforcement actions last year, in fiscal year 2013, which, as you mentioned, resulted in over $1.5 billion in fine collections. So it was in that sense a good return on the investment, when you consider the level of funding for the agency.

Right now, we are on pace to probably have fewer enforcement actions consummated and completed based on numbers midway through the year—midway through the fiscal year. There is a variety of reasons for that, but one of which is that we have lost some staff in the Division of Enforcement. So that does give you some indication about what the impact of reduced staffing can have.

Again, there could be other reasons for that as well. It could just be the nature of incidents that have been brought to the attention of the agency this year are different than in years past, but it is one thing you might want to take a look at.

So I have some concerns about that. That is one of the reasons why we have asked for additional attorneys for the Division of Enforcement at the agency. Our request would bring us roughly 50 additional FTEs. And again, I think we would continue to demonstrate with that enhanced team an ability to bring a good return for the taxpayer.

Senator COONS. Thank you.

Thank you for what you do, Chair White, at the SEC. I have a sense that you are charged with overseeing more than 25,000 market participants roughly who engage in trillions of dollars worth of economic activity, and I think what the SEC does is, like the CFTC, critically important to a well-functioning capital market that is secure and transparent.

SEC ENFORCEMENT EFFORTS

And as we continue to heal from the financial crisis, I think it is critical we take steps to ensure that doesn't happen again. Given the very broad range and significant expansion in your responsibilities and given that, as is the case I just referred to, you don't cost anything to the taxpayers, net-net, I support funding the President's request at $1.7 billion. But I would be interested in your comments on the trends of security frauds that you are seeing in current enforcement efforts and what sort of risks retail investors are exposed to. I would also be interested in how you see progress in rulemaking to implement the JOBS Act.

Ms. WHITE. In terms of the enforcement efforts, I think there is nothing more important than a strong, a very strong enforcement

presence by the SEC to protect investors—retail, as well as institutional—to protect the integrity of our markets, to protect the markets so that capital formation will be facilitated.

The SEC had, and much of this before I arrived, but in terms of the financial crisis cases, I think an extraordinarily strong record. The agency charged over 165, I think it was 169, entities and individuals. Seventy-plus of those were actually senior executives—chief executive officers (CEOs) and chief financial officers (CFOs). Enforcement actually got orders to return over $3 billion in fines and disgorgement. So there is obviously value—not only value added there, but it is actually returning under our Fair Funds provision money to investors.

So we are just about through. We have some additional financial crisis cases that obviously we are focused on completing. One of the things that we have done—really, two of the things that we have done since I have been there to strengthen the enforcement function is to form two new task forces. One is a financial reporting and auditing task force, which I think is the core of investor protection. And that is something that is already yielding results for the benefit of investors and the markets.

We have also formed a microcap fraud task force, which particularly targets that brand of securities fraud on retail investors.

Another very disturbing pattern—and I have seen this when I was a prosecutor, too. And it is some of the most egregious frauds you see are what I call the affinity frauds, when somebody commits a Ponzi scheme or other kind of investment scam really against their own communities. And we are certainly seeing really a growth in those, and so we are very focused on dealing with those. We have brought a number of different cases.

We have also intensified our enforcement efforts vis-à-vis the obligations of exchanges to make sure they are following the various what I call the market structure rules of our equity markets, which I think is important to everyone.

INVESTMENT ADVISOR EXAMINATIONS

And then one final point I would make is just talking earlier about our need for resources to increase the number of examinations we do of investment advisers. And of course, they are the ones that are really day-to-day dealing with your everyday investor, and we are only able to cover a very small percentage of those under current funding.

And when we go to those places—and frankly, when we go to the broker-dealers we examine as well—we find a lot of issues. So it is these issues that make us at least understand the critical importance of sufficient funding to be able to carry out those responsibilities for investors.

And actually, by just showing up on an exam—I think since fiscal year 2012, just showing up and pointing out, "By the way, those fees should not have been charged to those investors or those funds. They should have been for your account." We have returned, I think, $28.8 million just by showing up. So it shows you across the span I think the benefits to investors.

SEC TRAINING FOR NON-U.S. REGULATORS

Senator COONS. One last question, if I might, Mr. Chairman.

One other area that I was surprised to see in your report is that I didn't realize you were engaged in training non-U.S. regulators.

Ms. WHITE. Yes.

Senator COONS. It was roughly 1,700 in fiscal year 2013, I think it is 1,400 this fiscal year and next. What are the benefits of that program? How does it benefit us to provide training to non-U.S. regulators whose markets may not be as robust or scalable or secure?

Ms. WHITE. I think there has been significant benefit and has for decades, frankly, but even more so now. The securities markets, and certainly the securities frauds markets, are quite global. I mean, they don't respect borders.

And so, I think the training that we provide is invaluable to the American investor who may well be defrauded from any country you could name abroad. If they have a strong enforcement function, we are protecting the American investors there.

And we have seen an awful lot of progress. There is much more to go, but I think it is an invaluable service to the American investors. It is also I think an invaluable service really to the global markets and the integrity of them.

Senator COONS. Thank you.

Thank you, Mr. Chairman.

Senator UDALL. Senator Coons, thank you very much.

Senator Johanns, please proceed.

Senator JOHANNS. Mr. Chairman Wetjen, let me ask you a question. But let me also, if I might, lay some groundwork for this question so you know where I am coming from.

EFFECTS ON END-USERS

I think all of us agree that the CFTC must have smart, forward-leaning regulation. The market changes so dramatically. And yet, we still have to be sensitive to the potential to over-regulate. We don't want to regulate everything that moves. So trying to be—to strike that balance I think is key.

One example of regulatory overreach that I have been working on since Dodd-Frank passed is margin requirements on end-users when trading derivatives. I can state unequivocally Congress never intended for nonfinancial end-users to be subject to costly margin requirements, and yet here we are, almost 5 years later, still battling with this.

So I have introduced legislation that exempts end-users from margin requirement. This is not a Republican versus Democrat issue. The measure has gained strong bipartisan support. A companion bill has already passed the House with over 400 votes.

This is one of those things that should be done. I don't know of a Senator that opposes it. Maybe there is one out there that I haven't come across yet. But again, I think Congress is nearly unanimous on this.

I asked Gary Gensler about it one time, and I always felt that he had a pretty aggressive view of regulating things. I think that is what he saw his job as, and he was going to regulate stuff. But

he even agreed that nonfinancial end-users don't pose a risk to the system and, therefore, should not be burdened with what I would call a job-killing margin requirement.

I would like you—I know this is an issue now in the Fed's hands, but I would like your thoughts personally, as the acting chair of the CFTC, on what I am trying to get done here.

Mr. WETJEN. Senator, I agree with you that Dodd-Frank tried to, if I can use these words, hold harmless as much as possible the end-user community as it related to title VII in particular.

Senator JOHANNS. Right.

Mr. WETJEN. And we have a number of rules that provided exemptions from clearing requirements for end-users, and we have taken a number of different other actions as well to build out that general principle. And one specific area has to do with interaffiliate trades between companies that are not swap dealers. And so, we have done a considerable amount of work there.

So I agree with you in principle that that was a message and intent behind Dodd-Frank. At least as it relates to title VII, end-users are supposed to largely be left out of the grip, so to speak, of the new rulemakings implementing title VII.

I am not familiar with the details of the Fed's proposal, and I don't recall exactly where they are in the process. But I agree in principle with what you are saying as it relates to end-users in title VII.

Senator JOHANNS. Mm-hmm. See, Mr. Chairman, the Creighton education kicks in, and good, practical, common sense stuff come out.

Thank you. I will yield.

Senator UDALL. Senator Coons, did you have additional questions? Okay.

Chair White, one of the key components of Dodd-Frank was a mandate that the SEC adopt a number of new rules relating to credit rating agencies. And all of us remember what a key role credit rating agencies played in the kind of meltdown that we were in back in that time period.

And of these new rules, we included annual reports on internal controls, conflict of interest with respect to sales and marketing practices, various disclosure requirements, and consistent application of rating symbols and definitions.

What is the status of the SEC's efforts to comply with the mandates under Dodd-Frank relating to credit rating agencies, and what further developments can we expect from the SEC on this?

CREDIT RATING AGENCIES

Ms. WHITE. A very important area, a very high priority for the agency.

The agency did in January 2011 adopt, actually, a new rule requiring Nationally Recognized Statistical Rating Organizations (NRSROs) to disclose representations and warranties and how investors might enforce breaches of those. In May 2011, the agency proposed the rules you are alluding to. I think they proposed that 11 be amended to accomplish the objectives that you listed and 5 new ones. We are moving those forward quite actively, and they are a priority to complete this year.

Senator UDALL. Do you believe there are additional reporting requirements or controls necessary to prevent another crisis?

Ms. WHITE. There is no question in my mind that the credit rating agency issues played a significant role in the financial crisis. And I think the issues you have identified are ones that do need further reforms, and that is the objective of these rulemakings.

Senator UDALL. Okay. And I know that some of the critics have kind of come at this and said we should start over again. I assume that isn't the position of the SEC at this point.

Ms. WHITE. Well, we are certainly listening to all comments. Obviously, the formal comment period is closed, but we are listening very carefully to those who think that certain aspects perhaps should be re-proposed or done differently and perhaps not require a re-proposal.

So we are trying to come out with very robust rules, and we are continuing to listen to all critics and all supporters and really all ideas on it.

Senator UDALL. Right. Thank you very much.

Senator Johanns, do you have—and it looks like Senator Coons has completed his questioning here.

Let me thank both of you. We really appreciate having you here today. We appreciate this frank discussion and exchange of ideas.

We want to thank everyone who participated in preparing for this hearing. You have excellent staff. We do also, and we very much appreciate their help.

Today's discussion I think has provided helpful insights into these—your operations and I think shows us what the challenges are that are ahead of us. This information will be instructive as we further consider the budget proposals and develop our fiscal year 2015 bill during the coming weeks.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open until next Wednesday, May 21 at 12 noon for subcommittee members to submit statements and/or questions to be submitted to the witnesses for the record.

QUESTIONS SUBMITTED TO HON. MARY JO WHITE

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

STRENGTHENING EXAMS AND OVERSIGHT—FREQUENCY OF REVIEWS

Question. The SEC's Office of Compliance, Inspections and Examinations (OCIE) is responsible for conducting examinations of the Nation's registered entities. These include broker-dealers, transfer agents, investment advisers, the securities exchanges, clearing agencies, as well as self-regulatory organizations.

Chair White, your budget materials state that during fiscal 2013, the SEC was able to examine only about 9 percent of registered investment advisers. That means only 1 of every 12 of investment advisers is inspected. What do you believe would be a more suitable frequency?

Answer. As you point out, during fiscal year 2013, the SEC examined about 9 percent of registered investment advisers, comprising approximately 25 percent of the assets under management. As I stated in my testimony, clearly more coverage is needed, as the status quo does not provide sufficient protection for investors who increasingly turn to investment advisers for assistance navigating the securities markets and investing for retirement and family needs.

Examination staff uses a risk-based approach designed to focus its limited resources on those firms and practices that pose the greatest potential risk of securities law violations that can harm investors and the markets. These high-risk firms

frequently are large and complex entities, and examinations of them often take significant time to complete.

While we believe our risk-based approach has helped us to more efficiently use our resources to better protect investors, an increase of exam frequency to between 30 and 50 percent of investment adviser firms annually would further enhance our effectiveness and bring us closer to the current broker-dealer coverage level that, combined with examinations conducted by the Financial Industry Regulatory Authority, is approximately 50 percent.

Going forward, we will continue to use technology and risk-based data analytics to be as efficient as possible with our limited resources.

Question. What are the drawbacks of sporadic inspections?

Answer. OCIE staff's direct engagement with registrants allows the staff to provide first-hand information to the Commission and other SEC staff regarding the activities of our regulated entities, helping us prevent fraud, identify compliance deficiencies, promote compliance, inform policy, and monitor risk. Less frequent examinations therefore limits the information available to the Commission in discharging its mission to protect investors, including by reducing the instances in which we may identify potential fraud and other wrongdoing and also reducing incentives for registrants to put in place rigorous internal controls and compliance programs.

Sporadic or less frequent examinations also factor into business decisions that may not always be in the best interests of clients or customers. For example, OCIE staff has identified an increase in firms choosing to de-register as broker-dealers, or to conduct a greater percentage of their business as investment advisers. The staff believes that in some cases this shift could be due in part to the perception of less rigorous oversight of investment advisers.

Question. Your request for fiscal 2015 seeks $373 million, a $72 million increase for the exams function above current spending. This will support 316 additional staff positions above the 967 current level. What impact will those enhanced funds have on accelerating the frequency of exams?

Answer. The number and percentage of investment advisers examined each year depends on a number of factors, including the type and scope of the examinations conducted, the program priorities, the complexity of the advisory business, and staffing levels. Of the 316 positions for OCIE, we anticipate using 240 for investment adviser exams.

Our best estimate, as reflected in the budget request, is an investment adviser coverage level of 9 percent in fiscal year 2014 and 12 percent in fiscal year 2015. The time it would take in fiscal year 2015 to hire and train new employees likely means we would not realize the full effect from this staffing increase until future years. OCIE estimates that with the requested fiscal year 2015 staffing increase, the exam program would be able to cover at least 14–15 percent of the population in fiscal year 2016. This outcome could vary depending on a number of factors, including new program priorities or higher than expected staff attrition/turnover rates. To achieve an annual examination level of 30 percent to 50 percent would require incremental increases in subsequent budgets to permit the agency to hire and sufficiently train the necessary complement of examiners.

MARKET TRANSFORMATION AND HIGH-FREQUENCY TRADING

Question. Chair White, as the leader of one of our key financial regulators, you are acutely aware of the growing challenges facing your agency in monitoring the markets. We now have significantly transformed, globalized, round-the-clock, and highly diversified marketplace. Stock exchanges can now execute trades in less than a half a millionth of a second.

What is the current status of the SEC's oversight of high-frequency trading and automated trading environments?

Does the SEC presently have the necessary talent and technology in place to monitor and analyze high-frequency trading, to inform your regulatory and enforcement work, and guard the integrity and safety of the markets? What are the deficiencies?

Answer. Generally, the SEC's ability—in enforcement, examination, and regulation—to monitor and analyze high-frequency trading (HFT) activity in the U.S. markets has increased as more tools have become available to SEC staff, including software that can handle larger data sets and more advanced and powerful computers.

Data and Analysis of HFT Activity

The SEC has developed improved data sources and capabilities that can be used to analyze HFT activity.

Most prominently, we have launched an equity market structure website[1] that builds on an analytical tool called MIDAS (Market Information Data Analytics System), which enables us to quickly analyze enormous amounts of trading data across markets.[2] Though MIDAS does not identify individual firms, MIDAS data is now used in conjunction with existing investigations of specific firms. In particular, OCIE examiners and Enforcement staff use MIDAS to compare the individual trades and quotes of a particular firm (acquired from the firm itself) in the context of all other contemporaneous market trades and quotes. These types of analyses can help inform investigations on a variety of issues, such as those relating to insider trading and market manipulation.

SEC staff also is now analyzing information that recently has become available to it though the Large Trader Reporting Rule[3]—which provides SEC staff access to information about the trading activity of the largest market participants, including many HFT firms, upon request—into its policy-making, examination, and enforcement efforts.

Barriers to the development of comprehensive and reliable analyses of HFT remain, however, and include: (1) the limitations of available data;[4] (2) the absence of a clear, commonly agreed definition of HFT; and (3) inherent complexities in the econometric techniques available for assessing the effect of HFT on market quality. To help surmount these barriers, the SEC is in the midst of an initiative to expand the data available to regulators. Specifically, in July 2012, the SEC adopted Rule 613, which requires the self-regulatory organizations to submit a national market system (NMS) plan to establish a consolidated audit trail (CAT) for NMS securities, across all U.S. markets, from the time of order inception through routing, cancellation, modification, or execution.[5] When the consolidated audit trail is fully implemented, regulators will be able to readily tie all order and trade activity in NMS securities throughout the U.S. markets back to particular accounts and to properly sequence that activity in time. Fully implementing CAT is a high priority for the Commission.

A significant impediment to the SEC's ability to monitor and analyze HFT trading is the absence of comprehensive data that links orders and trades to individual market participants. Although current data resources allow the SEC to monitor and analyze overall market quality, questions regarding outcomes for end-users and intermediaries are often difficult to answer without account-level data. Data from CAT will facilitate many types of studies that are difficult to conduct with current data.[6] CAT will also significantly improve regulators' ability to monitor the trading activity of individual firms, the overall level of HFT activity in the market, and the outcomes realized by end-users of the market.

Oversight of Operational Risks in Automated Trading

To address the risk of instability and disruption that can arise in an automated trading environment, the SEC and the securities industry have undertaken a series of responsive initiatives. "Limit up-limit down," for example, is now fully implemented and moderating price volatility in individual securities.[7] Market-wide circuit

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[1] The web site is located at http://www.sec.gov/marketstructure/and is broadly intended to promote a market-wide dialogue and fuller empirical understanding of the equity markets. It serves as a central location for SEC staff to publicly share evolving data, research, and analysis about HFT and other market structure issues.

[2] MIDAS is an SEC system that collects equity quote and trade data from the consolidated public tapes as well as the individual data feeds that are commercially available from each equity exchange. That system supports a variety of powerful applications across the SEC's enforcement, examination, and regulatory functions, including research to better understand a market structure with a significant amount of HFT trading. This research in turn helps better inform policy decisions related to market structure issues, including HFT.

[3] *See* Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46959 (August 3, 2011).

[4] There currently is no comprehensive data source that enables regulators to tie all order and trade activity in the U.S. equity markets back to particular accounts. Accordingly, an exhaustive analysis of HFT activity is not possible at this time.

[5] *See* Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012).

[6] Examples of such studies include: how different types of market participants provide liquidity, and how liquidity provision from different market participants impact market quality at times of market stress; whether aggressive HFT strategies increase investor trading costs or serve to provide short-term liquidity at a premium; whether certain HFT strategies crowd out passive liquidity suppliers, and if so, how the costs of end-users are affected; and whether improvements in price efficiency allow liquidity providers to provide more liquidity to institutional orders.

[7] SEC Press Release No. 2012–107, "SEC Approves Proposals to Address Extraordinary Volatility in Individual Stocks and Broader Stock Market" (June 1, 2012).

breakers are in place to address volatility across the equities, options, and futures markets.[8]

The SEC has taken additional steps to require market participants to address their technology risks. We adopted—and are vigorously enforcing—the Market Access Rule, which requires brokers to have risk controls in place before providing their customers with access to the market.[9] Last March, the Commission proposed Regulation Systems Compliance and Integrity (SCI) to put in place stricter requirements relating to the technology used by exchanges, large alternative trading systems, certain exempt clearing agencies, and securities information processors—the SIPs.[10] The staff is now completing a recommendation for final rules.

The SEC has closely focused on certain market infrastructure systems that are "single points of failure" that can halt or severely disrupt trading when a problem occurs. The exchanges have responded with technology audits of the SIPs and a series of specific enhancements to improve SIP robustness and resilience. In addition, the exchanges have developed more robust SIP backup capabilities, and at the end of June 2014 implemented a new "hot-warm" backup, with a 10-minute recovery standard.

Further Enhancements to HFT Oversight

In addition, I recently publicly outlined a series of initiatives that will, among other things, enhance the SEC's oversight of HFT firms and automated trading tools.

—The SEC staff is now developing a recommendation to the Commission for an anti-disruptive trading rule that would address the use of aggressive, destabilizing trading strategies in vulnerable market conditions. Such a rule will need to be carefully tailored to apply to active proprietary traders in short time periods when liquidity is most vulnerable and the risk of price disruption caused by aggressive short-term trading strategies is highest.

—The SEC staff is also preparing two recommendations for the Commission that are focused on using our core regulatory tools of registration and firm oversight: (1) a rule to clarify the status of unregistered active proprietary traders to subject them to our rules as dealers; and (2) a rule eliminating an exception from Financial Industry Regulatory Authority (FINRA) membership requirements for dealers that trade in off-exchange venues. Dealer registration and FINRA membership should significantly strengthen regulatory oversight over active proprietary trading firms and the strategies they use.

—Finally, the SEC staff is preparing recommendations for the Commission to improve firms' risk management of trading algorithms and to enhance regulatory oversight over their use.

I also have asked the exchanges and FINRA to consider including a time stamp in the consolidated data feeds that indicates when a trading venue, for example, processed the display of an order or execution of a trade. With this information, users of the consolidated feeds would be able to better monitor the latency of those feeds and assess whether such feeds meet their trading and other requirements.

ENHANCING CORPORATE DISCLOSURE OF MATERIAL RISK: CLIMATE CHANGE AND ENVIRONMENTAL IMPACTS

Question. Generally, publicly traded companies disclose business risks to investors through regular financial reports (called "10–K filings") submitted to the SEC.

Recently, there have efforts to ensure that environmental costs and risks are also reported to investors because they impact a company's bottom line. In July 2010, the SEC issued guidance requiring companies to address how climate change (and climate change regulation) could potentially impact their businesses. Like all SEC disclosures, this is aimed at informing market price and protecting investors. Yet, concerns have been raised that despite existing disclosure guidance, reporting by companies is not as robust as it should be. In response to this subcommittee's fiscal 2014 report, the SEC submitted an updated staff report focused on the quality, specificity, and thoroughness of disclosure related to climate change.

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[8] *Id.*

[9] SEC Press Release No. 2010–210, "SEC Adopts New Rule Preventing Unfiltered Market Access" (November 3, 2010). One market access risk is the potential for erroneously submitting a single large order or a flood of small orders that disrupt trading. *See* SEC Press Release 2013–222, "SEC Charges Knight Capital With Violations of Market Access Rule" (October 16, 2013).

[10] SEC Press Release No. 2013–35, "SEC Proposes Rules to Improve Systems Compliance and Integrity" (March 7, 2013).

I would be interested in hearing more about how the SEC is reviewing climate disclosures and the extent to which public companies are conforming to the guidance and making full disclosures.

Answer. The Commission's 2010 *Guidance Regarding Disclosure Related to Climate Change* provides interpretive guidance about how companies should evaluate climate change related issues when considering what information to disclose to investors under existing disclosure requirements, such as risk factors or management's discussion and analysis. Companies that are subject to SEC disclosure rules must provide climate change related disclosure if the information is material. The U.S. Supreme Court has held that information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision. Companies must consider their own particular facts and circumstances in evaluating whether information would be considered to be material.

As you noted, the SEC submitted a report on public company disclosures about climate change related matters to the Subcommittee earlier this year. The staff of the Division of Corporation Finance prepared the report based on its survey of climate change related disclosures by a number of companies in selected industries. Of those companies surveyed, most included risk factor disclosure about climate change related matters. The companies surveyed also disclosed climate change related matters in the business, management's discussion and analysis, executive compensation discussion, and legal proceedings sections of their filings.

The Division of Corporation Finance staff routinely reviews new issuer filings and periodic reports of public companies for compliance with applicable disclosure requirements and inclusion of material information. The goal of the staff's reviews is to monitor and enhance compliance with applicable disclosure requirements. In conducting its filing reviews, the staff will continue to consider whether a company has complied with applicable disclosure requirements, including with respect to climate change, in their filings. Where the staff has concerns about the adequacy of the disclosure in a filing, the staff will issue a comment letter asking the company for further explanation or additional disclosure.

ECOLOGICAL DISCLOSURE—POLLUTION EXTERNALITIES

Question. There is also growing concern that while the SEC requires public companies to disclose certain financial information, its disclosures do not take into account the possible costs imposed on public by corporate activities that have an adverse impact or pose material risk to public health and the environmental such as pollution damages.

What actions are underway at the SEC to evaluate public company disclosure of environmental and ecological risks?

Answer. A number of Commission rules and regulations may trigger disclosure of the possible costs and environmental and ecological risks stemming from corporate activities, depending on a company's particular facts and circumstances. The following provisions of Regulation S–K may require disclosure of environmental and ecological risks and associated costs, based on a company's particular facts and circumstances.

—Item 101 requires companies to disclose the material effects that compliance with environmental laws may have upon the company, as well as any material estimated capital expenditures for environmental control facilities.

—Item 103 requires disclosure of certain proceedings arising under environmental laws, including proceedings that involve a claim for damages, potential monetary sanctions, capital expenditures, deferred charges or charges to income if the amount involved exceeds 10 percent of the company's consolidated assets.

—Item 503(c) requires a discussion of significant risk factors, which could include environmental and ecological risks.

—Item 303 requires companies to identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.

The Division of Corporation Finance staff routinely reviews public company disclosures to monitor and enhance compliance with applicable disclosure requirements. Where the staff has concerns about the adequacy of the disclosure in a filing, including with respect to environmental and ecological risks and associated costs, the staff will issue a comment letter asking the company for further explanation or additional disclosure.

USTR SPECIAL 301 REPORT

Question. The United States Trade Representative (USTR) "Special 301" Report is an annual review of the state of intellectual property rights (IPR) protection and enforcement among our trading partners around world.

Does the SEC or the major U.S. exchanges take into account a foreign company's inclusion in the USTR Special 301 Report when considering whether to permit the company to be publicly listed?

Should the SEC or major U.S. exchanges take into account a foreign company's inclusion in USTR's Special 301 Report or its Special 301 Out-of-Cycle Review of Notorious Markets before allowing the company to be publicly listed?

What role do the SEC and major U.S. exchanges have in ensuring that US capital markets do not enrich companies that profit from intellectual property rights (IPR) infringement?

Answer. The U.S. Federal securities regulatory system as applied to listed companies is based on the principle of full and fair disclosure of information to investors, and the Commission does not consider the merits of the transaction or company during the registration process. A company is, however, required to provide disclosure of material risks and litigation to which the company is subject, including any material risks associated with a company's intellectual property or the enforcement of rights related to intellectual property.

As to the U.S. exchanges, section 6(b)(5) of the Exchange Act requires that, among other things, the rules of a registered securities exchange be designed to "prevent fraudulent and manipulative acts and practices," "promote just and equitable principles of trade," "remove impediments to and perfect the mechanism of a free and open market and a national market system," and "protect investors and the public interest." The exchanges have adopted rules relating to the qualification, listing and delisting of foreign issuers on their markets, which have been determined by the Commission to be consistent with the Exchange Act. These rules, among other things, set forth financial, corporate governance, and disclosure requirements that issuers must comply with in order to be eligible for listing. Furthermore, the exchanges generally retain broad discretion in their rules to deny the listing of a company (or suspend dealings in, or delist, a company's securities once listed) even if the company meets the listing or continued listing standards, if the exchange determines there are circumstances that make the initial or continued listing of the company inadvisable or unwarranted. Thus, pursuant to this broad authority, an exchange could take into account a company's country's inclusion in the USTR Special 301 Report or the Special 301 Out-of-Cycle Review of Notorious Markets when considering whether to permit the company to be publicly listed.

We understand that the exchanges are considering adopting procedures to ensure companies on the Special 301 Out-of-Cycle Review of Notorious Markets list are identified in the listing application process and would generally not warrant listing. The USTR Special 301 Report does not actually list foreign companies, but rather lists countries that have a particular problem with respect to intellectual property rights protection, enforcement, or market access for persons relying on such rights. To the extent a company from one of these foreign countries has applied to list on an exchange and has disclosed that there is a material risk or litigation about an issue related to intellectual property rights, the listing exchange would inquire about the issue and take it into consideration when considering the listing application of the company.

EXECUTIVE COMPENSATION

Question. The Dodd-Frank Wall Street Reform and Consumer Protect Act required a number of regulations on executive compensations to allow for greater transparency and to discourage the excessive risk taking that contributed to the economic crisis, including those outlined in section 956. There was also significant outcry after it was reported that banks who relieved taxpayer bailouts awarded their top executives nearly $1.6 billion in salaries, bonuses and other benefits the following year.

On March 2, 2011, the SEC issued a proposed rule made jointly with other regulators that would require certain financial institutions to disclose the structure of their incentive-based compensation and prohibit compensation that encourages inappropriate risks.

What is the expected timeline for the rule to be finalized?

How does the SEC plan to address the criticisms of the proposed rule?

Does the SEC believe that the proposed rule would have discouraged the troubling practices that contributed to the economic crisis? Will it help prevent future excessive risk-taking?

Is the SEC considering additional measures or actions on this issue?

Answer. In the spring of 2011, the SEC, acting jointly with the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, and the Office of Thrift Supervision proposed a rule pursuant to section 956. As required by the statute, the proposed rule would apply to bank holding companies, banks, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, broker-dealers, credit unions, and investment advisers.

In general, the jointly proposed rules drew upon the Guidance on Sound Incentive Compensation Policies finalized by the Federal banking agencies in the summer of 2010. The banking agency guidance is designed to address compensation structures that could cause imprudent risk taking.

The proposed joint rule is comprised of three parts:

—*Disclosures:* A covered firm would be required to file an annual report describing the firm's incentive-based compensation arrangements.

—*Prohibition on Encouraging Inappropriate Risk:* All covered firms would be prohibited from establishing or maintaining an incentive-based compensation arrangement that encourages inappropriate risks. This portion of the rule draws upon the banking agency guidance.

—*Deferral for Large Firms:* For covered firms with $50 billion or more in total consolidated assets, executive officers would have at least 50 percent of their incentive-based compensation deferred for at least 3 years. The deferred compensation could not be paid faster than on a pro-rata basis, and would have to be adjusted to reflect actual losses. The firm's board also would approve incentive compensation for individuals determined to have the ability to expose the firm to substantial losses.

The comment period for the proposed rule closed on May 31, 2011. The SEC and its fellow regulators received approximately 10,000 comment letters. Common themes in the comment letters included:

—Concern in applying a single mandatory deferral requirement to a broad array of firms with dramatically different businesses;

—How the proposed rule would apply to affiliates regulated by multiple agencies;

—How the proposed rule would apply to certain types of investment advisers; and

—Tax and accounting consequences.

The SEC staff is working closely with the staff of the banking regulators to consider these comments and how the jointly proposed rules could be revised to address commenters' concerns with those rules.

The SEC is also moving forward with enhanced disclosures related to executive compensation required by the Dodd-Frank Act. In the fall of 2013, the Commission proposed a new rule that would require public companies to disclose the ratio of the compensation of its chief executive officer to the median compensation of its employees. Advancing the other executive compensation rules required under the Dodd-Frank Act is also a near-term priority.

QUESTIONS SUBMITTED BY SENATOR RICHARD C. SHELBY

Question. In recent years, the SEC has responded to events like the 2010 flash crash or the concerns raised by Michael Lewis with narrowly focused studies of the problem at hand. While examining the latest problems and reassuring market participants is important, ad hoc reviews and immediate responses to crises often crowd out the opportunity to engage in deeper assessments of complex reform issues such as market infrastructure, off-exchange trading, and Regulation National Market System (NMS).

Given the growing complexity and fragmentation of our equity markets, are you supportive of calls for the SEC to undertake a comprehensive review of market structure?

Answer. Yes. As reflected in a recent public speech, I set forth three core principles that are grounding the SEC's review of equity market structure and guiding further actions: (1) all issues must be evaluated through the prism of the best interest of investors and the facilitation of capital formation for public companies; (2) we must account for the varying nature of companies and products, with a particular sensitivity to the needs of smaller companies; and (3) our review of market structure

must be comprehensive, including testing assumptions about long-standing rules and market practices.[11]

Addressing the issues of our current market structure demands a continuous and comprehensive review that integrates targeted enhancements with an expansive consideration of broader changes.[12] Accordingly, as we evaluate the merits of broader changes, we will also continue to assess and address specific elements of today's market structure that work against the interests of investors and public companies. In these remarks, I outlined the initiatives we are advancing across five broad sets of issues: market instability, high frequency trading, fragmentation, broker conflicts, and the quality of markets for smaller companies.[13] These initiatives are designed to address discrete issues that will, among other things, enhance transparency and the Commission's ability to oversee HFT firms.

While our review in each of these five areas has already resulted in discrete actions targeting specific issues, the more fundamental policy questions demand—and are receiving—close attention at the SEC. To facilitate engagement with market participants and the public, SEC staff will populate our market structure website with summaries of key issues that provide a framework for further analysis, identifying areas that the staff is focused on and where public perspectives are essential. To help in our review of equity market structure, I have also recommended to the Commission the creation of a new Market Structure Advisory Committee comprised of experts with a diversity of backgrounds and viewpoints. The new committee will serve as an additional forum and resource for reviewing specific, clearly articulated initiatives or rule proposals.

Question. In early July, the Commission's rules providing for the regulation and registration of municipal advisors will become effective. The Commission routinely publishes updated and final "Frequently Asked Questions" (FAQs) which provide practical information to firms seeking to comply with the rule. The Office of Municipal Securities provided general interpretive guidance on certain aspects of the final rules on May 19, 2014. However, FAQ's detailing the manner in which the rule treats wholly owned bank subsidiaries making tax exempt loans have not been finalized and published. It is my hope that these would be published well before the effective date so that covered entities have the time and opportunity to understand and comply with the rule.

When will you publish Commission FAQs relating to wholly owned bank subsidiaries?

Answer. The Commission's final rules for municipal advisor registration became effective on July 1, 2014. To address specific questions arising from market participants and to facilitate a smooth implementation of these major new rules, the staff in the Office of Municipal Securities provided interpretive guidance, in the form of frequently asked questions (FAQs), in January and May of this year.

In the May FAQs, the staff specifically addressed several questions raised by banks regarding implementation of the final rules, including: (1) the treatment of so-called "dual employees" of banks (i.e., individuals who are employed by a bank and also are associated with the bank's broker-dealer affiliate); (2) the applicability of the bank exemption to banks that provide advice to a municipal entity regarding the structure, timing, and terms under which the bank would purchase municipal securities for its own account; (3) the treatment of proceeds of pension obligation bonds; and (4) transitional guidance for identifying existing proceeds of municipal securities held in existing accounts or existing investments.

Although the staff did not provide specific guidance regarding the treatment of transactions in which wholly-owned bank operating subsidiaries make tax-exempt loans under the final rules, the staff issued an FAQ regarding the purchase of municipal securities by an institutional buyer in a principal capacity that may be relevant for these transactions. Specifically, in this FAQ, the staff stated that an institutional buyer would not be engaged in municipal advisory activity under the final rules if the institutional buyer only provides information regarding the terms under which the institutional buyer would purchase municipal securities for its own account and does not provide advice to the municipal entity regarding an issuance of municipal securities that would be offered to other investors. The staff believes that this guidance could be relevant to and useful for advice on transactions involving those wholly-owned bank operating subsidiaries that meet the general parameters specified in the FAQ.

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[11] *Enhancing Our Equity Market Structure,* Speech by SEC Chair Mary Jo White, at Sandler O'Neill & Partners, L.P. Global Exchange and Brokerage Conference New York, N.Y. (June 5, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312.

[12] *Id.*

[13] *Id.*

QUESTION SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. Chair White, you have received several letters, one signed by the Illinois Secretary of State (and 7 others) and the other by the Illinois Securities Commissioner (and 17 other Commissioners), expressing concerns about the SEC's proposal to preempt the States from reviewing Regulation A offerings. Under the JOBS Act, issuers are exempt from State review for shares traded on a national exchange or sold to a "qualified purchaser." The SEC's proposed rules define a qualified purchaser as "all offerees of securities in a Regulation A offering and all purchasers in a Tier 2 offering," applying to anyone and eliminating State review.

Many have suggested that with smaller offerings and newer issuers also comes greater risk and likelihood of fraudulent activity. Although your points on investor protection and costs associated with complying with State law are well-taken, states currently offer review on these smaller offerings that can further protect investors. States also have taken steps to harmonize review processes, streamlining requirements among states in response to concerns about the time and costs associated with complying with State review.

How will the SEC work with State regulators' to address concerns that preempting State authority beyond what Congress intended under the JOBS Act would limit the additional investor protections states can offer, especially in light of commitments to streamline State review processes to address issuer concerns?

Answer. As part of our ongoing dialogue with State securities regulators, Commission staff and I periodically meet with representatives of the states and the North American Securities Administrators Association (NASAA) to discuss developments in the securities markets and, where applicable, to address areas of specific concern.

With respect to the Commission's proposed rules for implementing Title IV of the JOBS Act, the Commission has received more than 100 comment letters on its rule proposal, many of which addressed the proposed approach to State securities law compliance. The staff is carefully reviewing the comments as it works to develop recommendations for final rules for the Commission's consideration. In addition, the staff is closely monitoring the development and implementation of NASAA's multi-State coordinated review program for Regulation A offerings. It should also be noted that the proposed rules would not limit in any way the states' authorities to pursue fraudulent offerings and would permit that all offers under proposed Regulation A be filed with a State with such a requirement.

I look forward to continuing our ongoing dialogue with State securities regulators and NASAA, including with respect to the Commission's proposal to adopt rules to implement title IV of the JOBS Act. Our objective for this rulemaking is to ensure that the framework and requirements for Regulation A offering are both workable and protective of investors.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

Question. Since becoming Chairman, have you found the SEC to have the right resources necessary to go after those that commit fraud, regardless of where the security is bought?

Answer. Since my arrival, we have made every effort to effectively—and efficiently—deploy our funds in order to identify, investigate and prosecute those within our jurisdiction that commit fraud. These efforts have resulted in a number of significant enforcement cases across our regulatory spectrum, including actions against exchanges to ensure they operate fairly and in compliance with applicable rules, actions against investment advisers and broker-dealers for taking undisclosed fees and for disrupting the markets through failures in their automated trading systems, important financial reporting cases against issuers, actions against auditors and others who serve as gatekeepers to our financial system, Foreign Corrupt Practices Act (FCPA) cases against large multinational corporations, actions against municipal issuers, landmark insider trading cases, and additional cases against individuals and entities whose actions contributed to the financial crisis.

That said, the SEC needs significant additional resources to keep pace with the growing size and complexity of the securities markets and the agency's broad responsibilities. Specific to our Enforcement program, we face a number of key challenges to preserve and enhance our ability to vigorously pursue the entire spectrum of wrongdoing within our jurisdiction. Our Enforcement work includes the detection, investigation, and litigation of violations of the Federal securities laws. In each of these areas, we face significant challenges:

—*Detection.* We receive over 15,000 tips, complaints, and referrals annually, including the more than 3,000 tips that flow into the Division's Whistleblower Office, which generate a fresh stream of case leads in need of investigation. The

review and analysis of these tips require significant human and technological resources. We also have focused intensively on potential misconduct in the equity markets and in connection with new rules, including those implemented under the Dodd-Frank and JOBS Acts. But detecting misconduct in constantly evolving securities markets, including as a result of the growth of algorithmic, automated trading and "dark pools," requires substantial resources.

—*Investigations.* Technological advances across the industry allow for more sophisticated schemes, which require improved technology and significant resources to unravel. We also are expanding our focus on financial reporting and auditing misconduct cases, which are highly technical and labor intensive.

—*Litigation.* We have seen an increase in litigation and trials as we focus more extensively on individual wrongdoing. And, the recent change to our long-standing settlement policy that now requires admissions in certain cases may lead to more litigation. Success at trial is critical to our ability to carry out our mission, and litigation, often against well-funded opposition.

In order to meet the challenges of our rapidly changing and expanding markets, with increasingly complex products and more sophisticated wrongdoers, Enforcement seeks to hire 126 new staff, including additional legal, accounting, and industry specialized experts, primarily for investigations and litigation. These critical resources will enable us to improve our information processing and analysis, expand our investigative capabilities, strengthen our litigation capacity, and better use technology. In addition, the Enforcement Division will continue to: (1) invest in technology that enables the staff to work more efficiently and effectively, and (2) collaborate with external stakeholders who assist in the Division's identification, investigation, and litigation of securities law violations, including wrongdoing that crosses borders.

Question. I believe private enforcement and investors' right to recover losses is very important, and serves as a deterrent to securities fraud. Would you agree and can you discuss how the SEC can work with victims of securities fraud to recover losses?

Answer. The SEC is fully committed to its mission of protecting investors and continuously strives to maximize the return of funds to victims of securities fraud whenever possible. This may consist of ill-gotten gains required to be disgorged and/or penalties imposed by a court in the Commission's enforcement actions. The Sarbanes-Oxley Act of 2002 enhanced the Commission's ability to more fully compensate harmed investors by giving us authority, in appropriate cases, to create Fair Funds through which we can distribute civil penalties (along with disgorgement) to victims. Prior to the Act, the Commission was required to transmit all penalties obtained to the U.S. Treasury. This Fair Fund authority is an important part of our effort to help harmed investors recover losses. Additionally, meritorious private actions can help supplement regulatory enforcement of the securities laws.

The SEC's Office of Distributions (OD) within the Division of Enforcement is responsible for overseeing the Commission's distributions program. The OD handles all distributions to victims in enforcement actions where a disgorgement fund exists or where the Commission or a court has created a Fair Fund that includes monetary penalties. The office was reorganized in 2011 to centralize the handling of distributions, develop expertise, and improve speed and efficiency in the distribution process. Its mission is to return money to harmed investors whenever practicable in a fair, reasonable, cost-effective, and efficient manner. It also seeks to promote awareness among injured investors about the distributions process through proactive outreach and targeted mailings.

The OD handles an average of 200 distribution funds at any given time. Since the passage of the Sarbanes Oxley Act, the SEC has returned more than $9.9 billion to harmed investors through its distributions. In fiscal year 2013, the SEC returned over $250 million to harmed investors through 22 different distribution funds. We are committed to continuing to work to maximize the return of funds to harmed investors whenever possible.

Question. There are reports that the SEC is considering allowing U.S. companies to utilize accounting standards from the International Standards Board to report their financial results in the United States. Could you comment on the validity of these reports, as well as the strengths and weaknesses of such an approach?

Answer. The Commission has long promoted the objective of a single set of high-quality globally accepted accounting standards. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working together to more closely converge U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS) since 2002. The FASB's ongoing work with the IASB on convergence projects has resulted in the elimination of many significant differences between U.S. GAAP and IFRS.

The Commission continues to monitor the progress of the remaining convergence projects.

Under the Commission's rules, foreign private issuers are permitted to file financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP. Today, over 500 companies, representing trillions of dollars of market capitalization, avail themselves of this method of reporting by submitting reports to the Commission as foreign private issuers using IFRS. Therefore, high-quality IFRS standards are critically important to the U.S. markets.

The Commission has not yet made any determinations as to whether there would be any further incorporation of IFRS into the U.S. financial reporting system. I believe it is important for the Commission to continue to consider the potential benefits and challenges of further incorporating IFRS into the U.S. financial reporting system. As we do, it is imperative to fully consider the interests of U.S. investors, the FASB's role as the standard setter of accounting standards for U.S. companies, and the role the United States plays in the development of global accounting standards.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

SEC REGISTRATION THRESHOLD UNDER SECTION 12(G)

Question. In implementing Section 401 of the JOBS ACT, the SEC proposed Regulation A+, which is intended relieve the reporting burden for small businesses by exempting securities offerings of less than $50 million annually from the registration requirements of the Securities Act. Additionally, the JOBS Act increased one of the registration thresholds under section 12(g) of the Exchange Act, by allowing up to 2000 accredited investors for companies with over $10 million in assets. Recently, Kansas businesses have expressed concerns about increasing asset threshold under 12(g) in order to match the exemption provided for public offerings in Regulation A+.

Has the SEC examined the effects of increasing the 12(g) asset threshold?

What is the policy rationale for such an increase? Do you believe that rationale is consistent with Congressional intent?

What is the SEC doing to make certain the reporting requirements for companies with assets of $10 million and 2000+ accredited investors are not more burdensome than requirements for companies with potential assets of up to $50 million?

Answer. As described in the Commission's rule proposal to implement new section 3(b)(2), often referred to as Regulation A+ exemption, a company raising capital under that exemption would have to comply with the requirements of Exchange Act Section 12(g) just as any other company would. That is, no matter how much a company raised in a Regulation A+ offering, if, at the end of the year it had more than $10 million of assets and 2,000 holders of record, it would be required to register under the Exchange Act.

Under the rule proposal, certain Regulation A+ issuers would be required to file annual and semiannual ongoing reports and current event updates that are similar to the requirements for public company reporting, but scaled for these issuers. In the proposing release, the Commission noted that such disclosures would benefit investors by providing a regular flow of information and would further the development of a market for the securities. The reporting obligations would be required even if the issuer has fewer than 2,000 holders of record and therefore does not meet the thresholds under section 12(g). The staff is carefully reviewing the public comment received on this rule proposal as it works to develop recommendations for final rules for the Commission's consideration.

With regard to Exchange Act Section 12(g), Congress established a $1 million total assets threshold in 1964. The Commission subsequently used its authority under Exchange Act Section 12(h) to raise the asset threshold several times, and raised it to $10 million in 1996. The changes made by the JOBS Act, which were effective immediately upon enactment, codified the $10 million threshold in the Exchange Act, but did not raise it.

The Commission staff is preparing rule recommendations to revise its rules to implement the changes made by the JOBS Act to section 12(g). When undertaking these rulemakings, as is the case with all rulemakings, the Commission and its staff are mindful of the economic effects associated with the requirements proposed or adopted, including the costs and benefits of regulation and potential effects on efficiency, competition and capital formation.

ACCREDITED INVESTORS

Question. Section 413 of the Wall Street Reforms and Consumer Protection Act of 2010 requires the SEC to examine its definition of an accredited investor to determine whether it should be modified "for the protection of investors, in the public interest, and in light of the economy." To qualify as an accredited investor, SEC requires an investor to earn an annual income over $200,000 or a net worth over $1 million, excluding a primary residence. There is concern among the angel investing community and new businesses across the country that a dramatic increase in the threshold for qualification as an accredited investor could limit the number of individuals who are able to provide capital to early stage businesses at their most critical juncture. GAO analysis of Federal data on household net worth showed that adjusting the $1 million minimum threshold to approximately $2.3 million, to account for inflation, would decrease the number of households qualifying as accredited from approximately 8.5 million to 3.7 million, or approximately a 56 percent drop in eligible accredited investors.

What criteria will the SEC use to determine whether or not to increase the threshold for qualification as an accredited investor?

Is there strong evidence that the current thresholds pose any risk for investors? What data suggests current accredited investors do not understand risk when making investments?

Answer. The Commission staff, including staff from the Division of Corporation Finance and the Division of Economic and Risk Analysis, currently is engaged in a comprehensive review of the accredited investor definition. The review and the feedback received through that process will inform the Commission's consideration of whether to change the definition of accredited investor, including whether net worth and annual income should be used as tests for determining whether a natural person is an accredited investor. As part of this review, Commission staff is also independently evaluating alternative criteria for the accredited investor definition suggested by the public and other interested parties. Careful consideration is being given to both the need to facilitate capital formation and the need to protect investors. Any possible changes to the definition would subsequently occur through the rulemaking process, which includes opportunities for public comment on any such changes and a thorough economic analysis of their potential effects.

ACCOUNTING RULES UNDER JOBS ACT

Question. The section 4(a)(6) exemption of the JOBS Act was intended to provide investors with protection in the form of disclosure while allowing companies an easy pay to accessing investment capital. Balancing these goals is why Congress included mandatory financial disclosures for companies seeking investment. However, Congress did not stipulate the basis of accounting required and deferred to the SEC to make that determination. In response, the Commission has proposed U.S. generally accepted accounting principles (U.S. GAAP), a standard basis of accounting designed for use by larger and public corporations. Many companies and crowdfunding platforms believe this requirement is unnecessary, unduly burdensome, and inconsistent with Congress's intent to create an exemption that was compatible with the reality of small business. As the National Federation of Independent Business (NFIB) has shown, most small businesses do not use U.S. GAAP accounting. In fact, only a small minority uses any sort of pure accrual-based accounting (of which U.S. GAAP is a subset) with the vast majority using either cash-based accounting or a hybrid method. Small businesses choose the method of accounting that makes the most sense for their needs, both in terms of how it reflects the reality of their business and the costs of preparation and compliance.

Why did the SEC decide to require U.S. GAAP as the preferred accounting practice?

Answer. As you know, the Commission has proposed rules to implement the crowdfunding provisions of the JOBS Act.[14] Under the proposal, companies would be required to provide financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The Commission considered a variety of factors when issuing the proposal, including that (i) financial statements prepared in accordance with U.S. GAAP are currently required for offerings under Regulation A, which is another exemption available to smaller issuers to raise capital; (ii) financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size of the issuer, which should reduce the burden of preparing financial statements for many early stage issuers; and (iii) some commenters suggested that the Commission require financial statements prepared in accordance with U.S. GAAP.

The Commission requested comment on the proposal and alternatives, such as whether financial statements should be prepared differently than under U.S. GAAP and, if so, which changes from U.S. GAAP would be appropriate The Commission also requested comment on whether the Commission should allow issuers to prepare financial statements using a comprehensive basis of accounting other than U.S. GAAP.

The Commission has received approximately 320 comment letters, including 30 form letters, on the crowdfunding proposal. Comments received on this aspect of the proposal were mixed, and contained a variety of suggested approaches. The Commission staff is reviewing these letters and will consider them carefully as they develop recommendations for final rules for the Commission's consideration.

AUDIT THRESHOLD

Question. In the JOBS act Congress established a tiered system of required financial disclosures that companies would have to meet in order to participate in an offering under Regulation Crowdfunding. Under the law, issuers offering more than $500,000 within a 12-month period, or such other amount as the Commission may establish, by rule, are required to provide audited financial statements. The Commission has proposed keeping the threshold for requiring an audit at $500,000. The $500,000 audit threshold as proposed has received criticism in both the media and comments to the Commission because of the prohibitive cost of audits for small companies, especially since the audit will need to be undertaken prior to the company being certain that it will secure funding. The Commission proposes to keep the threshold at $500,000 because "Congress specifically selected" it. However this is not true; Congress specifically gave the SEC authority to select a different threshold amount to avoid the very scenario that appears to be developing—that the audit requirement is too onerous for companies to comply with, excluding them from being able to take advantage of crowdfunding.

Is the SEC aware of concerns raised by small businesses interested in using crowdfunding?

Will the SEC monitor and potential modify these thresholds over time?

Answer. Title III of the JOBS Act, which establishes a new crowdfunding exemption, contains a number of requirements mandated by Congress, including those to ensure investor protection. As you note, the Commission proposed rules designed to implement the crowdfunding exemption and received approximately 320 comment letters, including 30 form letters, on the proposal. While some commenters were supportive of the Commission's proposal, other commenters expressed concerns about costs that may arise under the proposal, including costs associated with preparing audited financial statements. Commission staff is reviewing these comment letters and has been meeting with individuals and groups interested in sharing their views about the rule proposal. The staff is considering all of the feedback provided as it works to develop recommendations for final rules for the Commission's consideration. The Commission and staff appreciate the need to develop rules to implement the crowdfunding exemption in a way that both promotes capital formation while at the same time providing key protections for investors.

In issuing the proposal, the Commission noted its understanding that the proposed rules, if adopted, could significantly affect the viability of crowdfunding as a capital-raising method for startups and small businesses. Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses.

The Commission also directed the staff to develop a comprehensive work plan to review and monitor the use of the crowdfunding exemption under section 4(a)(6) and the rules the Commission adopts to implement crowdfunding. Upon adoption of the final rules, the Commission staff will monitor the market for crowdfunding offerings, focusing in particular on the types of issuers using the exemption, the level of compliance by issuers and intermediaries, and whether the exemption is achieving its objectives. This monitoring program will assist the Commission's efforts in evaluating the development of market practices in offerings made in reliance on the crowdfunding exemption and related rules. These efforts also will facilitate future Commission consideration of any potential amendments to the rules implementing crowdfunding.

ONGOING AUDIT REQUIREMENT

Question. The Commission has proposed a requirement that companies subject to an initial audit must undergo audits on a yearly basis until the securities are retired, the company becomes a reporting company, or the company liquidates or dis-

solves. This proposal is in no way mandated by the JOBS Act. The Commission justifies this requirement on the grounds of providing investors and potential secondary purchasers with up-to-date information. While this is an important objective, and was the reason for Congress requiring certain limited ongoing disclosures in the JOBS act, requiring ongoing audits is excessively expensive, burdensome, and ultimately contrary to the needs of small businesses and potential investors. The ongoing audit requirement will also render the cost-of-capital of crowdfunding higher than other sources of funding, possibly creating an adverse selection problem where the best companies avoid crowdfunding in favor of other types of offerings with less onerous requirements such as offerings made in reliance on Rule 506(c), leaving only companies for whom crowdfunding is the last resort in the marketplace.

Is the Commission aware of the concern about this requirement?

Why would the Commission treat crowdfunding investments differently than securities sold under Regulation A, which do not require a yearly audit?

Answer. While some commenters were supportive of the Commission's proposal, other commenters expressed concerns about costs that may arise under the proposal, including costs associated with preparing ongoing annual reports with audited financial statements. As indicated above in response to Question 3, Commission staff is reviewing these comment letters and has been meeting with individuals and groups interested in sharing their views about the rule proposal.

The crowdfunding provisions of the JOBS Act require ongoing disclosure, which differs from current Regulation A. Under the proposal to implement the crowdfunding provisions, a company's ongoing disclosure about its financial condition would have to meet the financial statement requirements that were applicable to its initial offering of securities. As a result, only companies whose offering statement included audited financial statements would be required to provide audited financial statements on a yearly basis until one of three terminating events occurs. The Commission requested comment on the proposed ongoing annual reporting requirement and will consider carefully the comments submitted on this requirement when adopting final rules.

QUESTIONS SUBMITTED TO HON. MARK P. WETJEN

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

IMPORTANCE OF CONDUCTING ANNUAL EXAMS

Question. Chairman Wetjen, the Commodity Futures Trading Commission (CFTC) regulates the activities of over 68,000 registrants who handle customer funds, solicit or accept orders, or give trained advice. These include commodity pool operators, futures commission merchants, floor brokers, floor traders, and salespersons. I understand that due to resource constraints, the CFTC is unable to conduct reviews more frequently than once every 3 years. Because of the triennial cycle, the ability to check compliance is diluted. Your fiscal 2015 budget request seeks $38.1 million dollars which will support 158 staff. That is 63 more staff than the 95 supported by the current spending level of $23.6 million dollars.

Would the requested funding permit more frequent reviews?

Answer. Yes. Currently, the Commission's review cycles of registered entities varies depending on many factors, including the Commission's available resources and whether an entity is considered systemically important. By fully funding the President's budget request, the Commission can move toward annual reviews of all significant clearinghouses and trading platforms and perform more proactive monitoring of higher risk market participants and intermediaries. Partially funding the request will mean accepting potentially avoidable risk in the derivatives markets as the Commission is forced to reduce the frequency of reviews and forego more in-depth financial, operational and risk reviews of the firms within its jurisdiction.

Question. What are some of the benefits CFTC could realize from the proposed increase in resources for the Exams functions?

Answer. The CFTC would be in a better position to monitor risk in the markets and entities we oversee, verify that registered entities are complying with our rules, and proactively monitor the activities of our registrants. This would also help the CFTC to ensure that the financial, risk, compliance and operational reports that we receive are materially correct. Likewise, the CFTC would be better able identify industry trends and assess new and emerging risks in the industry. Lastly, the CFTC would be in an improved position to proactively monitor and detect problems at firms sooner. The benefit to customers would be just as important as closer monitoring would help ensure the firms are following our customer protection rules.

Question. Would more frequent reviews require adding staff with enhanced expertise?

Answer. While our staff has, on average, 23.6 years of experience, the industry is constantly changing and becoming more complex. In enhancing its examinations program, the CFTC would expect to hire individuals with more specialized skills, and possibly train current employees to provide those specialized skills. The skills necessary for an effective examinations program include risk management, technology (including data security and data management), swaps expertise, liquidity analysis, market risk analysis, and operational risk analysis.

Question. Is the CFTC encountering any problems in acquiring the skills and experience needed to support the growth you project to need?

Answer. The key challenges the CFTC faces in this regard are having adequate resources to train existing staff and hire qualified new staff. An additional challenge the Commission faces when hiring new staff is that it competes for qualified staff directly with private sector employers who have significant financial resources at their disposal and are often able to provide greater compensation than public sector employers. Regarding our existing staff, the Commission faces challenges in retaining some of its most experienced and knowledgeable staff. In recent years, the Commission has had to reduce investments in training opportunities for existing staff. Such training is vital to retaining employees and updating their skills and knowledge about the markets we regulate and our agency's increased regulatory responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

MARKET TRANSFORMATION AND HIGH-FREQUENCY TRADING

Question. Chairman Wetjen, as the leader of one of our key financial regulators, you are acutely aware of the growing challenges facing your agency in monitoring the markets. We now have significantly transformed, globalized, round-the-clock, and highly diversified marketplace. Rapid, electronic, algorithmic trading platforms are replacing the traditional open-outcry trading floors.

What is the current status of the CFTC's oversight of high-frequency trading and automated trading environments?

Answer. The Commodity Exchange Act (Act) and Commission regulations are designed to protect market participants and the public from fraud, manipulation, abusive practices, and systemic risk related to futures and swaps. The Commission oversees designated contract markets (DCMs), swap execution facilities (SEFs), clearinghouses, futures commission merchants (FCMs), swap dealers (SDs) and other entities and intermediaries to monitor their compliance, and in the case of DCMs and SEFs, reviews their self-regulatory programs. DCMs are subject to 23 core principles under the Act and SEFs are subject to 15. As the front-line self-regulatory organizations, DCMs and SEFs have primary responsibility for identifying misconduct by all market participants, including those engaged in automated trading and high-frequency trading (HFT). The CFTC's Division of Market Oversight conducts rule enforcement reviews of DCMs' self-regulatory programs and evaluates their compliance with the Act and Commission regulations.

The Act and Commission regulations do not distinguish between HFT and non-HFT. "High-frequency trader" is not a distinct category of market participant within the Commission's regulations, nor is it a defined term or separate registration status. Applicable regulations and resources developed by the Commission to detect trading abuses are equally relevant regardless of the trading strategy used to effectuate the abuse. Many Commission rulemakings implementing Dodd-Frank apply to automated trading and HFT because the rules address trading on DCMs and SEFs, or apply to registrants who may engage in automated trading of HFT activity.

In April 2012, the Commission adopted Regulations 1.73 and 23.609 requiring FCMs, SDs and major swap participants ("MSPs") that are clearing members to establish risk-based limits based on "position size, order size, margin requirements, or similar factors" for all proprietary accounts and customer accounts. The rules also require FCMs, SDs and MSPs to "use automated means to screen orders for compliance with the [risk] limits" when such orders are subject to automated execution. The Commission also adopted rules in April 2012 requiring SDs and MSPs to ensure that their "use of trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of the program."

In June 2012, the Commission adopted rules to implement the 23 core principles for DCMs. Regulation 38.255 requires DCMs to "establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt

trading in market conditions prescribed by the designated contract market." Regulation 37.405 imposes similar requirements on SEFs.

The DCM rules also set forth risk control requirements for exchanges that provide direct market access ("DMA") to clients. Regulation 38.607 requires DCMs that permit DMA to have effective systems and controls reasonably designed to facilitate an FCM's management of financial risk. These systems and controls include automated pre-trade controls through which member FCMs can implement financial risk limits. Regulation 38.607 also requires DCMs to implement and enforce rules requiring member FCMs to use these systems and controls. The DCM rules also implement new requirements in the Act related to exchanges' cyber security and system safeguard programs. The Act and Commission regulations also address cyber security and system safeguards within SEFs.

Finally, the Division also conducts direct surveillance of its regulated markets, and continues to improve the regulatory data available for this purpose. For example, in November 2013 the Commission published final rules to improve its identification of participants in futures and swaps markets (OCR Final Rules). While enhancing the Commission's already robust position-based reporting regime, the OCR Final Rules also create new volume-based reporting requirements that significantly expand the Commission's view into its regulated markets, including with respect to HFT.

In addition to its current rules, on September 12, 2013, the Commission published a Concept Release on Risk Controls and System Safeguards for Automated Trading Environments. The Concept Release proposes consideration of a series of 23 additional pre-trade risk controls; post-trade reports; design, testing, and supervision standards for automated trading systems (ATS) that generate orders for entry into automated markets; market structure initiatives; and other measures designed to reduce risk or improve the functioning of automated markets. The Concept Release is intended to foster a public dialogue and inform the Commission as it considers what additional measures, if any, might be necessary to address automated and high-frequency trading.

The initial 90-day comment period closed on December 11, 2013, but was reopened from January 21 through February 14, 2014, in conjunction with a meeting of the CFTC's Technology Advisory Committee (TAC). The Commission received over 40 public comments on the Concept Release, including comments from DCMs; an array of trading firms; trade associations; public interest groups; members of academia; a U.S. Federal reserve bank; and consulting, technology and information service providers in the financial industry. CFTC Staff is currently studying all publicly submitted comments received and upon completing the review will make initial recommendations if necessary.

Question. Does the CFTC presently have the necessary talent and technology in place to monitor and analyze high-frequency trading, to inform your regulatory and enforcement work, and guard the integrity and safety of the markets? What are the deficiencies?

Answer. As noted above, the Commission's rules do not distinguish between HFT and non-HFT trading. The Commission does face challenges in making sure its technology and personnel are adequate to oversee trading in the markets, including HFT trading. The most significant impediment to enhanced Commission surveillance of HFT is insufficient staff and resources. In particular, the Commission does not have the resources in place to receive and analyze complete messaging (e.g., order book) data from DCMs or SEFs. Access to messaging data is critical to overseeing electronic trading because it permits analysts to reconstruct what actually happened during a particular trading period. With appropriate staff and technology, staff can use this data to detect disruptive trading practices such spoofing. Achieving comprehensive surveillance of electronic trading will require additional financial, staff and other resources not currently available to the Commission.

SUBCOMMITTEE RECESS

Senator UDALL. The subcommittee hearing is hereby adjourned.

[Whereupon, at 3:25 p.m., Wednesday, May 14, the subcommittee was recessed, to reconvene subject to the call of the Chair.]